

SEMIANNUAL REPORT OF THE INSPECTOR GENERAL

FOR THE PERIOD

April 1, 1997, To September 30, 1997

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 Semiannual Report, transmitted to the Congress by the SBA Administrator, covers the full range of SBA/OIG activities from April 1, 1997, to September 30, 1997.

In past reports to the Congress, I have regularly highlighted the extraordinary growth of the SBA portfolio over the last few years and the dearth of SBA/OIG resources available to provide much more than a modicum of oversight. This information and supporting data have been dutifully reported to the Congress but with little recognition, by its membership, of the risk to the American taxpayer created by the present situation.

While the Agency's portfolio continues to grow to new heights, i.e., an estimated \$38 billion by the end of FY 1997, the oversight context for this growth is about to change even more dramatically. A recent congressional mandate requiring that significantly more portfolio management activity, from loan origination to close out to liquidation, be turned over to the private sector has created a problem for OIG oversight operations. I say problem, rather than challenge, because OIG's criminal investigators currently receive over half of their referrals or leads from SBA employees involved in the administration of the Agency's portfolio. I am very concerned that a comparable commitment to fraud prevention and detection may not be shared by SBA's resource partners. Time will, of course, prove whether my concerns are valid. In the interim, a fundamental question remains: Should the American taxpayer be

asked to underwrite even more financial risk to the SBA portfolio, while its Government experiments with this significant change in public policy?

Obviously, the risk discussed above can be mitigated somewhat if the Congress would address the resource shortfall being experienced by the SBA/OIG. After all, there is little risk in funding more independent oversight resources for the OIG, particularly when one recognizes that it has consistently paid its own way as demonstrated by its continuing high return on investment (ROI). For FY 1997 alone, the OIG's ROI offers an impressive ratio of 7:1; that is, for every dollar the Congress appropriates for its operations, seven dollars are returned or put to better use through its audit, inspection, and investigation oversight activities. Actually, the ROI would be even higher if there was an acceptable methodology for pricing the myriad of internal consulting services provided to SBA policy and program managers on a daily basis. With only marginal productivity improvements that can be further extracted from the OIG staff, current OIG staffing is just plain inadequate for the task at hand, and I would be remiss in not reporting this fact to the Congress of the United States.

Another problem that has received national attention over the past reporting period is the substantiated fraud being perpetrated by a number of SBA's program applicants, which is exacerbated by the constraints placed on the OIG's ability to deal with it. As reflected in this report, an estimated 3.2 percent of SBA's Section 7(a) loan recipients fail to disclose criminal histories that could preclude loan approval. Furthermore, these borrowers are almost three times as likely to default on their guaranteed loan obligations than those without such histories. This means that in FY 1998 alone, individuals who do not meet the Agency's character eligibility test will receive a projected \$321 million in Government guaranteed loans that will cost taxpayers over \$30 million. Current SBA procedures and OIG resource constraints, however, prevent the OIG from conducting the background checks necessary to identify these ineligible borrowers and prevent these loans from being approved. I have, therefore, recommended to the SBA Administrator that all applicants for Section 7(a) financial assistance be thoroughly screened by the OIG prior to loan disbursements being made by a participating lender. This recommendation is not without cost implications, however. To conduct a pilot of this proposal in the fourth quarter of FY 1998, the Agency and/or the Congress will have to invest an estimated \$400 to \$500 thousand in the OIG's security investigations program and another \$500 to \$600 thousand thereafter per annum to implement the clearance program on a full time basis -- a small price to pay to ensure that the Nation's honest small business men and women have access to the estimated \$321 million in capital that would otherwise be provided to ineligible borrowers.

Turning to the OIG's performance over the reporting period, the SBA/OIG closed 45 investigative cases and obtained 30 indictments and 20 convictions, bringing the year-end totals to 52 indictments and 54 convictions. In addition, \$56 million was realized from management avoidance and court-ordered recoveries and fines during the year. For our other operating activities, year-end productivity totals stand at 26 audit and 4 inspection reports

issued and \$13 million in dollar accomplishments. The bottom line is that these OIG achievements enabled the Agency to operate more effectively and to make more funds available to qualified small businesses who meet the eligibility criteria for SBA assistance.

Beyond statistical productivity measures, what else has the SBA/OIG been able to accomplish? First, the success of the Agency's tax verification program continues to be impressive in terms of supporting the OIG's mission to prevent and detect fraud and abuse in SBA's programs and supporting operations. While the Agency formally adopted the OIG's recommendation to implement an income verification program in October 1994, the OIG started recording data on false tax return cases as early as FY 1992. To date, 99 individuals, from 11 states, have been indicted for submitting false financial information (or bogus copies of tax returns); 91 of those have pled or been found guilty; and 84 have been sentenced, producing \$20 million in court-ordered fines and restitutions. More importantly, \$34 million of requested loan amounts were never disbursed as a result of SBA's tax verification policy and the vigilance of its employees. These funds, of course, were subsequently made available to honest small business men and women who needed their Government's financial assistance. Moreover, the names of some 1,677 "non-filers" were given to the Internal Revenue Service for its review and appropriate disposition.

As for the SBA/OIG's efforts to promote economy, efficiency, and effectiveness in SBA's programs and supporting operations, this year's total of 30 audit and inspection reports speaks to our commitment. As a measure of the mutually beneficial and productive relationship that exists between the OIG and the SBA, over half of these audit and inspection reviews were, in fact, requested by SBA program officials. In addition, it should be understood that while such OIG activities may often be narrowly focused on a single program participant or a group of participants, much broader program policy issues are usually identified and brought to the attention of Agency policy and program officials for appropriate corrective action. Beyond the number of its formal audits and inspections issued, it is also important to convey the breadth of the OIG's general consultative activities. At the request of the Administrator, the Deputy Administrator, and other senior Agency officials, the OIG has also participated in the following major initiatives: assisting the Agency in reviewing and improving the quality of its standard operating procedures and regulations; assessing the breakdown in internal controls associated with its subsidy rate model; advising on the formulation of the SBA's strategic plan, as required by the Government Performance and Results Act; and participating in various Agency-wide initiatives targeted at fraud detection and prevention, contract assistance, and disaster assistance. The OIG also prepared its first 6-year strategic plan over the course of the reporting period; it was transmitted to the Congress on September 30, 1997, as an appendix to SBA's strategic plan.

Finally, I am pleased to report that the cooperation received from SBA's policy officials, senior executives, program managers, and employees during the conduct of

SBA/OIG audits, inspections, and investigations has once again been excellent. The OIG's working hypothesis continues to prove itself, i.e., the more closely OIG employees work with program managers, the more effective SBA will be in meeting the critical needs of the Nation's small business community. I trust the results reflected in this Semiannual Report to the Congress offer strong evidence that the OIG is meeting its responsibilities to the best of its ability.

James F. Hoobler
Inspector General

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Executive Summary

This report on the activities of the Office of Inspector General (OIG) of the Small Business Administration (SBA) is submitted pursuant to Section 5(b) of P.L. 95-452, the Inspector General Act of 1978, as amended. It summarizes OIG activities for the 6-month period from April 1, 1997, to September 30, 1997.

Summary of Accomplishments

OIG audits, inspections, and investigations over the last 6 months achieved \$24,649,175 in potential dollar results, 30 indictments, and 20 convictions. The dollar results consist of \$3,429,588 in potential recoveries, including judicially-awarded fines and restitution; \$15,044,652 in management avoidances; \$22,264 in disallowed costs agreed to by SBA's management; and \$52,671 in management commitments to use funds more efficiently. The results also include a \$6.1 million settlement related to audit work conducted during 1993.

The OIG alone could not have achieved the accomplishments set forth in this report to the Congress. The results for this reporting period reflect the cooperation and support of other Federal audit, inspection, and investigative components of organizations such as the Federal Bureau of Investigation (FBI); U.S. Secret Service (USSS); U.S.

Marshals Service (USMS); Internal Revenue Service (IRS); Office of the Comptroller of the Currency (OCC); Resolution Trust Corporation (RTC); Environmental Protection Agency's (EPA) Office of Criminal Enforcement; other Federal OIGs; and the Department of Justice (DOJ). Most importantly, the actions of SBA program managers and employees must be acknowledged. Indeed, much of our success is due to referrals made by these conscientious SBA employees.

OIG Mission for FY 1997

The OIG's mission for 1997 is delineated in its recently completed Strategic Plan for Fiscal Years 1997-2002. The first two goals of the strategic plan and their associated objectives provide a roadmap for the execution of the OIG's mission. The OIG's first goal is to **improve the economy, efficiency, and effectiveness of SBA programs** through the Agency's

adoption of recommendations resulting from the OIG's oversight activities. Achievement of this goal will be accomplished by meeting the following objectives:

1. Find opportunities for the reduction of operating costs (salaries and expenses) associated with and supporting activities of SBA's programs.
2. Identify means for reducing the subsidy cost of SBA programs.
3. Ensure that SBA programs are meeting mandated public policy goals, high performance standards, and the needs of targeted participants.
4. Improve the accuracy of SBA accounting and management information.
5. Assure Agency implementation of accepted OIG recommendations and, to the extent that OIG resources allow, provide assistance to program managers in implementing recommendations.
6. Reduce the opportunity for loan packager fraud through cooperation with Agency officials in the registration of loan packagers and the pursuit of packager investigations.
7. Review proposed legislation, regulations, standard operating procedures, and other SBA issuances to improve Agency programs and to eliminate the potential for mismanagement.
8. Identify program

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

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

1. Assist the SBA in its efforts to deter fraud and abuse by auditing a sample of defaulted loans and Section 8(a) program participants suspected of abusing the contracting assistance program.
2. Assist the SBA in deterring waste, fraud, and abuse by responding to complaints concerning such activities with OIG staff assistance and consultation.
3. Recommend actions to reduce any program vulnerabilities uncovered as a result of OIG oversight activities.
4. Conduct investigations into allegations of fraud in SBA programs according to the perceived level of risk to the Agency and the potential for program impact or increased deterrence.
5. Pursue asset forfeiture proceedings in all applicable cases.
6. Participate in development of SBA's fraud and corruption awareness training programs and emphasize cooperation of Section 7(a) lenders in combating fraud

through fraud awareness briefings and outreach contacts with lenders.

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

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

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

Highlights of the Past Six Months

Efforts to Improve SBA Program Management

White Paper Describing Critical Issues Facing the Small Business Administration Provided to SBA's New Administrator

In May 1997, the OIG provided Administrator Aida Alvarez a compendium of critical issues facing the SBA. The document presented a range of issues

facing the Agency and offered recommendations on actions to be taken. The critical issues identified were derived from recent audit and inspection oversight activities, as well as other program vulnerabilities identified through investigations conducted over the last few years. Additional issues and recommended actions, drawn from the experiences, perceptions, and concerns of OIG staff, were also shared in this same document. While acknowledging that resource shortfalls could be an impediment to reform, the Inspector General counseled that most shortfalls could be accommodated through a rational reprogramming of existing resources and increased productivity generated by the introduction of new management systems, use of state of the art technologies, and a retrained employee base that works "smarter" than ever before.

Lastly, the paper expressed the view that both OMB and the Congress would be more sympathetic to Agency resource needs if SBA could demonstrate that it had already done all it could do to make itself a model financial credit agency, as envisioned by the SBA Administrator.

Administrator Alvarez has distributed the critical issues paper to the Agency's program managers and is in the process of evaluating the OIG's recommended actions.

Inspector General Testifies Before the U.S. Senate Committee on Small Business Concerning the HUBZone Act of 1997

On April 10, 1997, the Inspector General testified before the U.S. Senate Committee on Small Business regarding SBA's ability to implement the HUBZone Act of 1997. The Act is intended to provide Federal contracting opportunities for small business concerns located in historically underutilized business zones. The Committee also specifically requested the Inspector General's views on SBA's management of the Section 8(a) contract assistance program and his judgment on whether the program is meeting its public policy purpose. A synopsis of the Inspector General's testimony is included in the Minority Enterprise Development chapter of this report.

CPA Firm Pays \$6.1 Million Settlement to SBA for Inadequate Audits

A major CPA firm agreed this year to pay \$6.1 million to settle SBA's claim that inadequate audits contributed to the Agency's loss when a large small business investment company (SBIC) failed.

Based upon the OIG Auditing Division's review of the CPA firm's working papers, SBA's General Counsel and the Department of Justice alleged that the firm was negligent in not requiring financial statement disclosure of risky participation agreements negotiated by the SBIC. After an arbitration panel ruled in favor of SBA, but declined to set damages, the parties negotiated a \$6.1 million settlement that was concluded in June 1997.

Follow-Up Audit of Agency's LowDoc Program Confirms Previous Findings

A follow-up audit of the Low Documentation (LowDoc) loan program confirmed the results of the report issued in September 1996. Each audit found that about 10 percent of LowDoc loans should not have been approved because of departures from required procedures.

The first report was based on a nationwide random sample of 70 LowDoc loans. At the request of the former Administrator, the Auditing Division repeated the audit with a larger sample of 120 loans, 30 each in Atlanta, Santa Ana, Washington, and Dallas. Separate reports were issued on the four offices; a consolidated report will be issued early in FY 1998.

Audit of Loan Guarantee Purchases Raises Conflict of Interest Issue

An audit of business loan guarantee purchases found that at least 8 out of 58 purchase decisions reviewed were inappropriate because lenders did not comply with SBA requirements in processing and servicing the loans. An additional nine purchases were not supported by sufficient documentation at the time of the decision, but documentation obtained during the audit found that five of these decisions were acceptable when all the facts were known. The auditors concluded that district offices may be too lenient with lenders because of an inherent conflict between pursuit of loan production and enforcement of SBA policies. The report recommended that SBA centralize the guarantee purchase function to eliminate the possibility of a conflict of interest at the local level of SBA operations.

Audit of Surety Company Results in Withdrawal of Claims Against SBA

One of SBA's largest preferred surety firms agreed to withdraw two claims totaling \$934,492 during an audit of the surety's claims. Both of the projects that led to the claims started before the bond was issued, a clear violation of SBA regulations.

Audit Finds That Disaster Home Loan Processing Complies with Regulations

An audit of disaster loan processing found that processing was **generally consistent with regulations**. About 91 percent of disaster home loan approvals were consistent with SBA regulations and procedures; the other 9 percent lacked support for repayment ability, credit worthiness, or other eligibility criteria. Disaster field office managers attributed the approval errors to limited training and experience and to policy imperatives on processing speed.

OIG Study Evaluates SBA and Lender Loan Liquidation Responsibilities

The OIG issued an inspection report on **Increasing Lender Liquidation Responsibility in the Section 7(a) Business Loan Program**. The report explores the potential for increasing Preferred Lender Program (PLP) and Certified Lender Program (CLP) lenders' responsibility for liquidating SBA loans. It concludes that SBA currently has in place sufficient regulations, procedures, and other controls to encourage lenders to obtain maximum recoveries and to allow

the Agency to take action for negligent liquidation actions. It also found, however, that SBA does not take full advantage of lender liquidation capabilities. Some districts give lenders a great deal of latitude, while others insist on making many of the liquidation decisions themselves. Given the Agency's reduced resources, the OIG believes SBA should no longer involve itself in step-by-step liquidation transactions on PLP- and CLP-defaulted loans. Instead, SBA needs to commit its resources to monitoring the way PLP and CLP lenders are handling these activities. The study is detailed in the Business Loan chapter of this report.

Activities to Enhance Fraud Detection and Deterrence

Results of False Tax Return Cases Increase

Over the last 7 years, the OIG has received 366 allegations that false tax returns were submitted in support of SBA business or disaster loan applications. These fraud referrals now involve loan applications submitted to 50 SBA district offices, totaling \$122 million and involving 1,194 individual subjects. To date, **99 individuals have been indicted on criminal charges**: 91 have been adjudicated guilty, 3 have had indictments dismissed, and 5 others are awaiting trial.

Affirmative Civil Enforcement Program

The OIG continues to expand the scope of its efforts to make optimal use of the Department of Justice's Affirmative Civil Enforcement (ACE) program. This

relatively new program targets cases for civil action which might otherwise not be prosecuted criminally because of the minimal dollar amounts involved, absence of financial loss to the Government, or because the facts of the case might not support a criminal prosecution. Heretofore, the OIG's success with the ACE program was focused in only 15 states and the Commonwealth of Puerto Rico; however, over the course of this reporting period, the OIG also realized its first ACE results in Maryland, Missouri, and South Carolina.

During the time that the OIG has been involved with the ACE program, it has had a total of **95 successful cases**, resulting in **\$2,853,260 in civil penalties** and **\$4,085,900 in recoveries**. Individual ACE outcomes are reported in the program area chapters, as appropriate.

Leaders of Incorporated New York State Village Indicted for Conspiracy, Embezzlement, Fraud, and Money Laundering

Six men from an incorporated village in Rockland County, New York, were charged with participating in a number of fraudulent schemes to obtain tens of millions of dollars through the Specialized Small Business Investment Company (SSBIC) program and other Federal and State grant, loan, and subsidy programs. The charges in the indictment, all related to the incorporated village, include **conspiracy, embezzlement of Federal program funds, making false statements, mail fraud, wire fraud, mortgage fraud, and money laundering**. The U.S.

Attorney's Office for the Southern District of New York asked the SBA/OIG to join its ongoing investigation with the IRS and the respective OIGs of the Departments of Education and Housing and Urban Development.

Business Loan Program

SBA's small business loan programs serve one of the most important missions of the Agency: to ensure that Federal funds and resources are used to help finance qualified small enterprises. Under the **Section 7(a) Guaranteed Loan Program**, SBA guarantees loans to small businesses that are unable to obtain private financing. These loans must be of such merit, or be so secured, as to reasonably ensure repayment to the lending institution. No loan may be made unless the financial assistance is not otherwise available on reasonable terms from elsewhere in the credit market. Under the guarantee 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 averages about 75 percent.

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 **Certified Lender Program (CLP)** or its **Preferred Lender Program (PLP)**.

Lenders who are heavily involved in the SBA guarantee program and meet the Agency's criteria can participate through the **CLP**. Over 1,000 participating lenders, approved for the **CLP** program, are permitted to assume greater authorities and responsibilities in processing, closing, servicing, and liquidating loans. As a result, SBA can process loan guarantee applications in 3 days, rather than the 2 weeks that it may take for a thorough analysis by Agency staff. About 9 percent of all business loan guarantees are made through the **CLP** process.

As permitted by Section 7(a)(2) of the Small Business Act, SBA delegates even wider authority to preferred lenders, i.e., lenders who can commit the Agency to guarantee eligible business loans and decide the level of SBA participation. This program, with over 400 participants, reduces processing time on strong credit applications and uses the resources of SBA's best lenders to the maximum. About 31 percent of all business loan guarantees are made through the **PLP** process.

The **504 Loan Program** provides long-term, fixed-rate financing through certified development companies (CDCs) to small businesses to acquire real estate, machinery, and equipment for expansion of business or modernizing facilities. Typically, 504 loan proceeds

are provided as follows: 50 percent by an unguaranteed first mortgage bank loan, 40 percent by an SBA-guaranteed debenture, and 10 percent by the small business customer. The maximum SBA debenture is \$1 million.

With the creation of the Agency's Low Documentation (**LowDoc**) application process, lenders are now able to use their own internal loan application documents, plus a single page, two-sided SBA form to apply for an SBA guarantee on a loan of \$100,000 or less. The demand for this program is unprecedented, i.e., **33 percent of all Section 7(a) loan approvals are currently made through the LowDoc application process.**

Summary of OIG Activity / Business Loan Program	
Audits Underway	11
Audit Reports Issued	7
Indictments Resulting from Investigations	12
Convictions Resulting from Investigations	8
Investigations Closed / Remaining Inventory	25 / 150
Investigations: Restitutions / Fines / Other Recoveries	\$1,178,176 / \$209,500 / \$56,300
Investigations: Reduction to the Agency's Financial Risk	\$15,831
Investigations: Loan Declinations Due to Name Checks	45 / \$13,775,624
Investigations: Cases Referred to Other Agencies	16
Inspections Underway	1
Inspection Reports Issued	1
Reviews of Proposed Regulations	1
Reviews of Standard Operating Procedures	2
Reviews of Other Issuances	27

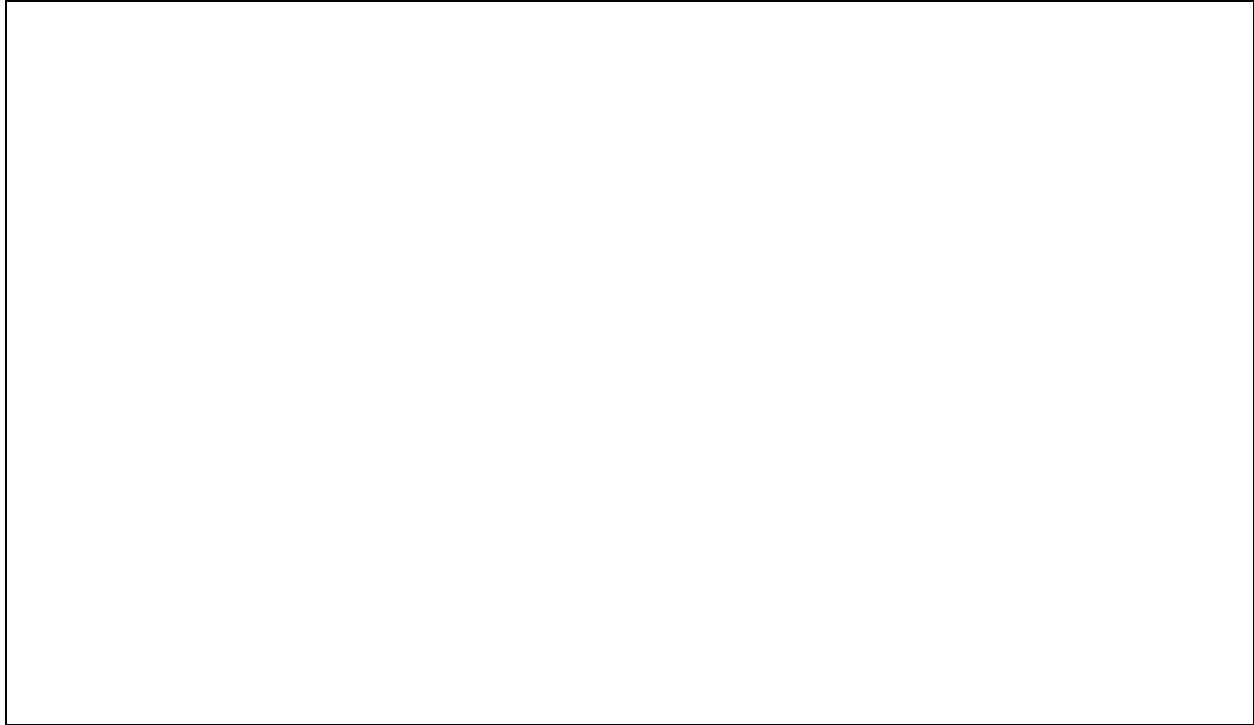


Figure 1

Efforts to Improve SBA Program Management

Review of Subsidy Rate Calculation Error Identifies Internal Control Weaknesses

In June 1997, the General Accounting Office (GAO) uncovered an error in SBA's formula for calculating its loan guarantee subsidy rate. This rate is critical in determining the Agency's lending levels and its supporting budget requests. SBA Administrator Alvarez asked the Inspector General to investigate the source of the error and to recommend future safeguards.

The OIG's study concluded that the initial error had resulted from OMB's incorrect data entry into the SBA's subsidy rate model. While SBA officials reviewed OMB's changes to the model's

assumptions, they failed to check the impact of the changes on the model's spreadsheet cells upon its return to the Agency for review. The OIG's recommendations included establishment of internal controls for the model's management, introduction of safeguards to prevent such errors from being made in the future, and development of a check list to ensure the review of changes both to the model's assumptions and data.

Follow-Up Audits of LowDoc Loans in Four District Offices Yield Results Similar to Previous National Sample

In a follow-up to an audit of a national sample of LowDoc loans, the OIG audited LowDoc activity at four SBA District Offices (Atlanta, Dallas, Santa Ana, and Washington). In the earlier review,

auditors concluded that 7 of 70 sampled loans should not have been made because of loan origination deficiencies. In the four follow-up audits, a total of 13 of 120 **sampled loans were judged deficient enough that they should not have been made.** The most prevalent of 157 deficiencies found by auditors involved (1) failure to perform IRS verifications or to reconcile them to the borrowers financial information when obtained, (2) failure to require equity injections or failure to obtain evidence thereof, (3) improper use of loan proceeds or failure to verify proper use, and (4) failure to use joint payee checks to disburse loan proceeds when required. Although most of the deficiencies pertained to non-compliance with general Section 7(a) program requirements, as opposed to requirements specific to the LowDoc program, the lenders cited loan officer error and lack of knowledge of the requirements as the most common reason for the deficiencies. The four District Office reports were issued in July of 1997.

All four District Directors agreed to provide training.

Audit Recommends Centralization of Loan Guarantee Purchasing to Avoid Conflict of Interest

An OIG audit recommended **centralizing the business loan guarantee purchase process** to eliminate the district offices' inherent conflict as both the Agency's marketer and regulator. It reviewed a random sample of 58 purchase decisions out of the Agency's 2,819 purchases valued at \$434 million for FY 1995. The audit found that at least eight of the purchase decisions totaling \$333,730 were

inappropriate due to SBA mistakes or leniency in evaluating lender errors. The lenient evaluations could all stem from the district offices' dual roles of marketing SBA loans through the lenders and providing oversight to those same lenders.

The conflicting roles force district offices to balance favorable working relationships with lenders against the need to impose sanctions if SBA regulations are violated. A statistical projection to all purchase decisions made in FY 1995 estimated there could be 389 inappropriate guarantee purchases totaling \$16.2 million. Other audit recommendations included the recommendation that SBA recover the \$333,730 paid on the inappropriate purchase decisions identified. The Acting Associate Administrator for Financial Assistance agreed with the majority of the audit's recommendations.

Follow-Up Program Vulnerability Memorandum Issued on Checking for Undisclosed Prior Defaulted SBA Loans

In July 1997, the Inspector General issued a program vulnerability memorandum (PVM) to the acting Associate Deputy Administrator for Economic Development (ADA/ED). This was a follow-up to a February 1994 PVM, citing an Agency program **vulnerability regarding the approval of SBA loans to applicants who fail to disclose personal or business liabilities from prior defaulted SBA loans.** In a summer 1994 response, the Associate Administrator for Disaster Assistance--the only SBA official to respond--spelled out his office's procedures for checking the names of every applicant's principals and proposed guarantors against

records of prior SBA loans and debts. The Office of Financial Assistance (OFA) claims that staff shortages and workload have prevented it from resolving the IG's concerns.

In the absence of a response from the OFA, the follow-up PVM identified another four SBA-guaranteed loans valued at \$1,030,000 which were made to applicants who failed to disclose their connections to previously defaulted SBA loans. On these defaulted loans, SBA eventually lost \$913,641. Research conducted during the course of the investigations indicated that processing loan officers in SBA's field offices only query the computer files for prior SBA loans and related outstanding debts when applicants voluntarily disclose their respective existence. The Office of Economic Development lacked a uniform policy requiring such queries in those instances where the applicants had not voluntarily disclosed their prior loans. Unfortunately, SBA's computer system did not allow queries to be made by using the addresses of the applicant businesses, their principals, or proposed guarantors. If such a query were allowed by the computer system (and required by SBA), two of the four loans discussed in the 1997 PVM would not have been made as the principals and/or guarantors had not changed their addresses since the earlier defaults.

To ensure applicants' eligibility prior to approving new loan applications, the OIG recommended that the responsible SBA offices should be required to query SBA's computer files using the names and Social Security numbers of all principals and

guarantors reflected on the loan application. This procedure would ensure that SBA personnel are made aware of any prior loans and outstanding debts associated with loan guarantee applicants. In addition, the OIG recommended that SBA consider augmenting its computer system to allow queries using the addresses of the businesses, principals, and proposed guarantors as search keys. As of the end of FY 1997, this remains an outstanding issue.

SBA Has Adequate Controls in Place But Does Not Take Full Advantage of Lender Liquidation Capabilities

An inspection report examined the role of Section 7(a) lenders in the liquidation process and explored the potential for increasing their responsibility for liquidating SBA loans. The OIG concluded that **existing controls in the liquidation process should adequately protect the interests of the Government, if they were consistently and effectively applied.**

SBA has in place a number of regulations, Standard Operating Procedures (SOPs), and other controls that encourage lenders to obtain maximum recoveries or allow SBA to take action against lenders for negligent liquidation actions. Controls include the requirement of a lender liquidation plan, a reduced guarantee percentage on Section 7(a) loans, the ability to deny or repair SBA's guarantee liability, special requirements for participation in the CLP and PLP programs, and laws outlined in the Uniform Commercial Code governing the

sale of certain collateral. The lenders in our sample believe that these measures provide effective incentives and disincentives and safeguard SBA's interests when objectively and uniformly applied.

The OIG also concluded that **SBA currently does not take full advantage of lender liquidation capabilities**. SBA should no longer play a role in routine liquidation transactions for PLPs and CLPs, especially given the Agency's resource constraints. Instead, SBA needs to commit its available resources to the effective monitoring of lender liquidation activities. This approach would make more efficient use of SBA resources.

At the district level, two distinct and equally entrenched points of view exist about how much responsibility lenders should be given to liquidate loans. Some districts give lenders a great deal of latitude, while others have adopted a more conservative approach by making many of the liquidation decisions themselves. Inconsistencies among district offices have often confused and frustrated lenders seeking guidance on liquidation policies and procedures. SBA recognizes this problem and is addressing it with policy notices intended to encourage greater consistency. The Agency is also making an effort to upgrade its information systems used for monitoring liquidation activities.

The OIG found substantial differences of opinion between lenders and SBA officials regarding the ability of lenders to take on more liquidation responsibility and to maximize recoveries. Most Agency

officials expressed reservations about relying on the liquidation capabilities of lenders, while most lenders stressed the advantages of handling liquidations without any SBA intervention. Because of deficiencies in performance data on individual lenders, district officials are, however, seriously hampered in assessing the lenders' ability to handle liquidation responsibilities.

There appear to be no compelling operational reasons for keeping PLP and CLP lenders from assuming full responsibility for liquidating their SBA-guaranteed loans. All credible lenders have procedures for loan liquidation, and banks are tightly regulated by Federal and State government agencies which uniformly require written liquidation procedures. Further, as a pre-condition for entering the PLP or CLP programs, lenders are required to demonstrate the ability to liquidate loans.

Based on these findings, the Inspector General recommended that the Associate Administrator for Financial Assistance:

1. Develop policies to refocus SBA's efforts away from direct involvement in liquidation activities and toward improved oversight of PLP and CLP liquidation performance;
2. Use the new decision-making authority given to PLPs and CLPs to conduct a test of a hands-off liquidation policy; and
3. Create a reliable method for

collecting data to measure individual lender liquidation performance.

Georgia Borrower and Participating Lender Withhold Information Which Could Have Avoided Government Loss

In one of a continuing series of **audits of early defaulting loans**, the OIG's Auditing Division discovered that both a borrower (a business with several principals) and an SBA participating lender failed to disclose material information that could have precluded approval of a \$455,000 loan to buy a golf driving range in Georgia in 1994. The loan defaulted in less than 1 year, resulting in SBA's honoring its \$340,000 loan guarantee. The audit revealed that the borrower failed to disclose either to the lender or to SBA prior felony convictions for check fraud and drug possession.

Through SBA's tax verification process with the IRS, the lender learned that a principal's 1992 tax return, showing a liability of \$2,600, had not been filed. The lender, however, did not disclose this fact to SBA. After the borrower declared bankruptcy, tax liens totaling \$26,000 were filed by the State of Georgia and the IRS. The OIG recommended that SBA recover the guarantee amount from the lender because the loan agreement required that the borrower be current on all taxes. In addition, the applicable SBA Policy Notice requires that the lender notify the Agency if there is any material discrepancy between the tax return data submitted by the borrowers and the data received from the IRS. Finally, SBA regulations state

that the Agency is released from its guarantee obligation if the lender has not "substantially complied with all of the provisions" of the regulations and lender agreements.

Neither the lender nor SBA's Atlanta District Office agreed with the recommendation. The lender said it was not required to get IRS verification of principals' tax returns on a new business and that tax return verification on the principals was, nonetheless, acceptable for 1991 and 1993. The District Office agreed that the lender did not have to verify personal tax returns of the principals and believed that there was no basis for action against the lender unless there was ultimately a loss in liquidating the loan. The OIG requested the District Office to reconsider its position because the lender should have disclosed the tax discrepancy once it was known. Further, SBA regulations do not require a monetary loss as a condition of release from the guarantee liability. The issue remains unresolved pending reconsideration by the District Office and SBA's Office of Financial Assistance.

Business Loan Program SOPs Reviewed

As part of SBA's initiative to update and streamline its SOPs, the OIG reviewed and commented on two business loan program SOPs. The review of SOP 50 50 4, Loan Servicing, led to comments on procedures for referring suspected irregularities to the OIG, adopting methods to identify lenders in need of review, and incorporating "credit elsewhere" evaluations as part of the review. In reviewing SOP 50 51 2, Loan

Liquidation, the OIG commented again on procedures used for referring suspected irregularities to the OIG and suggested that procedures should be added for referring charged-off loans to either the Credit Alert Interactive Voice Response System (CAIVRS) or the Government-wide database to be established by the Department of Treasury.

Guides for the Preferred Lenders Program Reviewed

The OIG reviewed two guides prepared for the Preferred Lender Program (PLP). The review of the proposed PLP review process led to the comment that the Agency, upon discovery of a material deficiency, should immediately seek resolution with the lender rather than wait for the lender to request SBA's purchase of the guaranty. Additional comments included requiring the review team to study all previous review reports and the lender's implementation of recommended corrective action, and having the review team confirm that the lender is using the tax verification process. The OIG also reviewed PLP liquidation guidelines and recommended that lenders be required to review the books and records of the borrowers during site visits and verify compliance with program regulations and loan provisions, retain site visit records for a specified time, and conduct post purchase reviews for all secondary market loans within the same time frame as required for other loans.

Activities to Enhance Fraud Detection and Deterrence

Latest Results from Affirmative Civil Enforcement (ACE) Program

Over this reporting period, the OIG's participation in the Department of Justice's ACE program produced six successful business loan cases, resulting in a \$50,000 recovery and \$51,250 in civil penalties. Five cases, all of which produced the civil penalties, involved fraudulent representations (primarily bogus tax returns) in loan applications, all of which were stopped before funds were disbursed.

The other case involved a \$100,000 LowDoc loan on which the participating lender bank had already disbursed \$53,000 when significant discrepancies between tax returns submitted to the IRS and the bank were identified. The balance of the loan was then canceled.

OIG Briefs Members of Lender Community

During this reporting period, OIG investigations staff continued its practice of making presentations to groups of participating lenders. Senior investigators from the Los Angeles and Chicago field offices gave presentations to 75 participants in Los Angeles, California; Seattle, Washington; and Anchorage, Alaska, highlighting the benefits to be gained from cooperating with OIG personnel in combating waste, fraud, and abuse in the Agency's guaranteed loan programs.

Idaho Farm Supply Company President Indicted for Bank Fraud, Money Laundering, and Bankruptcy Fraud

The former president of a Caldwell, Idaho, farm implement business was indicted on **2 counts of bank fraud, 1 count of wire fraud, 11 counts of bankruptcy fraud, and 6 counts of money laundering**. Also included in his indictment was a demand for criminal forfeiture of assets which he allegedly hid from the bankruptcy court. FBI and SBA/OIG special agents arrested the man, and the FBI seized his Range Rover vehicle. The joint SBA/OIG, FBI, and IRS investigation found that the company president made several false statements to obtain a \$750,000 SBA-guaranteed loan, a \$250,000 revolving line of credit, and a \$210,000 short-term bank loan. The investigation also found that he used over \$1 million of the company's funds for his family's personal gain, including the purchase of a luxury home and several luxury vehicles. The company was forced to file for bankruptcy and, during the course of the bankruptcy proceedings, allegedly diverted accounts receivable to other bank accounts under his control and hid assets from the bankruptcy trustee by filing false liens on some of the assets he had purchased with company funds. In addition, during a bankruptcy hearing, the company president made several false statements in response to the judge's direct questions. The current loss on the SBA-guaranteed portion of the loan is above \$86,000.

Two Massachusetts Trade Association Employees Indicted on Host of Charges

Two residents of Stoughton, Massachusetts, were indicted on **13 counts of conspiracy, mail fraud, wire fraud, and making false statements to a**

Federally-insured financial institution.

The organizer of a Massachusetts-headquartered trade association and its office manager were charged with a scheme to defraud a number of interstate truckers. The trade association put together 46 SBA loan applications to cover the purchase of trucks, submitted them to a participating lender bank in Wisconsin, and handled all insurance arrangements. The pair allegedly submitted loan application documents that, unbeknownst to the truckers, fraudulently overstated the cost of the insurance and pocketed the difference when the loans were disbursed. During 1993-1994, the difference amounted to \$215,546. The trade association's assistance to its Massachusetts members also allegedly included a scheme to defraud the Commonwealth of Massachusetts of its 5% sales tax on the purchase of each truck. The two trade association employees informally contracted with a New Jersey resident to file truck registration documents with the New Jersey Department of Motor Vehicles and accept the truck titles mailed in response. The loans were guaranteed by SBA as part of a pilot program started at the request of the trade association's organizer. Based on a referral from SBA's Boston District Office, the investigation is being conducted jointly by the SBA/OIG and the FBI.

Illinois Machine Manufacturer Pleads Guilty to Making False Statement

The former owner of an industrial machine manufacturing company in Dolton, Illinois, pled guilty to one count of knowingly **making a false statement** to influence

SBA. The firm was approved in February 1992 for a \$325,000 SBA-guaranteed business loan, of which \$42,500 was to be used to purchase machinery and equipment. The owner subsequently submitted an SBA settlement sheet that certified that he already had spent \$38,500 of the loan proceeds to purchase a milling machine and would spend an additional \$4,000 to purchase more machinery. The OIG's investigation documented that his certification was false; he actually spent only \$2,000 on machinery and equipment.

To carry out this fraud, the man submitted to the participating lender bank fraudulent invoices totaling more than \$43,000, as well as a \$7,700 check that he falsely represented as a 20 percent down payment on a milling machine. The owner also forged the endorsement of the joint payee of a \$30,800 check the bank gave him to pay the remaining 80 percent cost of the machine. The OIG initiated the investigation based on a referral from a liquidation loan officer in SBA's Chicago District Office.

Georgia Motel Owner Pleads Guilty to Making Material False Statements

The former owner of a motel in Tybee Island, Georgia, pled guilty to two counts of **making material false statements** to influence the actions of SBA. Approved for a \$950,000 SBA-guaranteed business loan, he submitted falsified invoices to the participating lender bank, representing \$213,150 in services and equipment, to obtain the loan proceeds. The OIG initiated this investigation based on information received by the OIG Fraud Line.

Pennsylvania Business Loan Applicant Pleads Guilty to Making False Statements

A Lansdale, Pennsylvania, loan applicant pled guilty to **making false statements** to influence SBA to approve a \$200,000 guaranteed loan to his company. In applying for the loan, the applicant submitted a 1991 tax return which had been altered to substantially overstate his income; he also submitted fictitious returns for 1992 and 1993. The loan proceeds were to be used to purchase a tavern, but the loan was subsequently canceled when the tax return discrepancies were confirmed by the IRS. The case was based on a referral from SBA's Philadelphia District Office.

Wisconsin Businesswoman Indicted for Making False Statement

A business consultant in Menomonie, Wisconsin, was indicted on one count of **making a material false statement** to SBA to obtain a \$25,000 SBA-guaranteed business loan. The indictment charges that she knowingly failed to disclose a recent criminal history and provided a false Social Security number on SBA Form 912, Statement of Personal History, in a loan application for her consulting firm. The OIG's investigation found that she had been arrested on a local charge for forging company checks the day before applying for the SBA-guaranteed loan, and she was convicted on that charge after obtaining the loan. The OIG initiated the investigation in response to a request from the U.S. Attorney for the Eastern District of Wisconsin.

Florida Auto Repair Shop Owner Sentenced for Using Falsified Tax Documents

The president of a Longwood, Florida, auto repair shop was sentenced to 2 years probation and a \$50 special assessment. He previously pled guilty to one count of **using false documents**. The businessman had submitted tax returns that he knew to be altered in an effort to obtain a \$450,000 SBA-guaranteed loan. The loan application was denied based on the overwhelming differences between the copies of tax returns submitted to SBA and those submitted to IRS. This investigation was based on a referral from SBA's North Florida District Office.

New York Bank Officer Sentenced for Witness Tampering

A former administrator and assistant to the general manager at a New York City participating lender bank was sentenced to 2 years probation and a \$5,000 fine. The woman had pled guilty to **witness tampering** in connection with a joint OIG and FBI investigation into kickbacks and fraud involving the bank's small business loan division. According to her plea, she attempted to prevent a witness in a grand jury proceeding from testifying. She asked the witness to withhold information from the grand jury concerning the nature of a \$5,000 payment he made to another bank officer who headed the bank's small business loan division. That bank officer was ultimately convicted of receiving kickbacks from SBA borrowers, and the bank paid a \$1,260,033 civil settlement

and released SBA from guaranties totaling more than \$3.5 million.

Washington Company Owner Charged with Making False Statements

The president of a company which owned several sandwich stores in the Tacoma, Washington, area was charged in an information with **making false statements** on a loan application to a Federally-insured financial institution. While applying for a \$322,197 SBA-guaranteed business loan, the man provided allegedly fraudulent guaranties, financial statements, and other documents to a participating lender bank and SBA. The OIG investigation found that he forged the signature of one shareholder and had several employees forge the signature of another shareholder on the guaranties, financial statements, and other supporting documents. In addition, the investigation found that he converted SBA collateral by selling it to a leasing company through a third party and leasing the equipment back from the leasing company. The investigation, conducted jointly with the FBI, was based on a referral from the bank to the U.S. Attorney's Office.

Two California Businessmen Charged with Bank Fraud

The owner of a car wash in La Crescenta, California, and the owner of a grocery store in Pasadena, California, were each charged with one count of **bank fraud**. The OIG was asked to join an investigation already underway by the FBI and the IRS, into an allegation that a Pasadena tax practitioner was responsible for the

preparation of altered tax returns submitted to financial institutions and SBA. SBA records revealed that the car wash owner had received guaranteed loans totaling \$805,000 and that the grocer had received a \$255,000 SBA-guaranteed loan. The investigation confirmed that "copies" of their Federal tax returns, submitted to the participant bank during the loan application process, had been altered from those submitted to the IRS in an effort to overstate their incomes substantially.

Results of Previously Reported Investigations

Former New York Bank Directors Sentenced for Conspiracy, Fraud, and Bribery

The former president (and board chairman) of a now-defunct SBA participating lender headquartered in Watertown, New York, and a former counsel to the bank were sentenced for **conspiracy, bank fraud, and bank bribery**. The OIG investigation revealed that the bank's president had agreed to refer the bank's legal work to the attorney's law firm in return for one-sixth of the legal fees collected. The bank officer received more than \$332,000 from the scheme and caused the bank to make loans totaling \$1,879,500 to the attorney and his associates, allowed other individuals to borrow money from the bank for transfer to the attorney, and permitted the attorney to represent both parties in connection with the closing of most of these loans.

California Jewelry Store Owner Sentenced for Making False Statements

The former owner of a retail jewelry store in San Luis Obispo, California, was sentenced to 21 months imprisonment, 3 years supervised probation, a \$5,050 fine, and \$336,894 in restitution (82.5 percent payable to SBA and 17.5 percent payable to the participating lender bank). He had been convicted of **making false statements** to a Federally-insured financial institution (submission of fictitious tax returns to support applications for \$550,000 in SBA-guaranteed loans).

Ohio Automobile Repair-Shop Owner Sentenced for Conversion of Government Property

The owner of an automobile repair facility in South Euclid, Ohio, pled guilty to one **felony count of conversion** of Government property in connection with a \$50,000 SBA-guaranteed LowDoc business loan. He was sentenced to 3 years probation, 300 hours community service, \$8,170 in restitution, and \$200 in court fees.

Illinois Farm Equipment Manufacturer Sentenced for Making False Statement and Unlawful Disposal of Hazardous Waste

A manufacturer of grain wagons and other farm equipment in Arthur, Illinois, was sentenced to 5 years probation, a \$100,400 fine, and \$97,112 restitution to the State of Illinois' Hazardous Waste Fund. The corporation had pled guilty to one count of **making a false statement** to obtain a \$1 million SBA-guaranteed loan and one count of unlawful disposal of hazardous

solvents and paint wastes.

Montana Clothing Retailer Sentenced for Making False Statements

A partner in a clothing retailer in Whitefish, Montana, was sentenced to 3 years probation and a \$7,500 fine. He had pled guilty to one count of **making false statements** to SBA. In 1993, the man submitted financial statements and other documents purporting to give a true picture of the partnership's financial situation to persuade SBA and a Montana participating lender to accept an "offer-in-compromise" for his liability for two defaulted SBA loans (\$780,000). Subsequent to SBA's 1993 acceptance of the compromise, the owner (under a corporate name) received three additional SBA-guaranteed loans totaling \$205,000 from another participating lender in Idaho based on a substantially different set of financial statements.

California Tax Preparer Sentenced for Making False Statement in Loan Application

A tax preparer in Los Angeles, California, was sentenced to 3 years probation, 100 hours community service, and a \$10,000 fine. He had pled guilty to **aiding and abetting the making of false statements** in a loan application to a Federally-insured bank, i.e., he prepared altered copies of income tax returns submitted in support of a \$265,000 loan application by the owner of a restaurant in Pomona, California.

California Talk Show Host Sentenced for Lying on Loan Application

A Los Angeles, California, businessman and former radio talk show host was sentenced to 4 months home detention, 3 years probation, 300 hours community service, and \$100,000 restitution to SBA. He had pled guilty to one count of **making a false statement** in a loan application to a Federally-insured financial institution. The investigation disclosed that the businessman signed an escrow modification statement which falsely stated that she had paid him \$160,000 outside of escrow. The \$160,000 "payment" was submitted as evidence to both the participating lender bank and SBA that the purchaser had made the necessary capital injection into her project to qualify for an SBA-guaranteed loan.

Missouri Osteopath and Convenience Store Owner Sentenced for Making False Statement

The owner of a convenience store in Liberty, Missouri, was sentenced to 6 months home confinement, 3 years probation, and \$58,000 restitution to SBA. Based on an investigation by the OIG, the man previously pled guilty to **making false statements** to obtain a \$300,000 SBA-guaranteed loan from a "non-bank" participating lender located in the geographical area served by SBA's St. Louis District Office. In his loan application, the owner failed to disclose tax debts and a defaulted 1977 loan to a group of his health clinics to SBA's Kansas City District Office; he also submitted copies of Federal tax returns which had been altered to overstate his income.

New York Software Company and its Chief Executive Sentenced for Money Laundering and RICO Violations

Under the provisions of the Racketeer Influenced and Corrupt Organization (RICO) statute, a Syracuse, New York, warfare-simulation software development company and its chief executive officer (CEO) were recently sentenced. The firm was sentenced to 1 year probation and \$478,000 restitution; the CEO was sentenced to 8 months imprisonment, 1 year home confinement, 1040 hours community service, 3 years supervised release, and a \$30,000 fine. The man had pled guilty to one count of **money laundering**, and the firm had pled guilty to **being a criminal enterprise under the RICO statute**, both in connection with the firm's \$750,000 SBA-guaranteed loan. In return for the guilty pleas, the Government agreed to dismissal of the other charges in a 54-count indictment alleging that they defrauded the Navy, the participating bank, investors, and creditors of over \$8 million.

The investigation found that the company's principals had failed to disclose a significant debt when applying for the loan and then used loan proceeds to pay off the debt. The OIG conducted this investigation jointly with the Defense Criminal Investigative Service, which brought the case to the OIG's attention.

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 loan Federal 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 non-profit 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. 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 1997, SBA approved 49,515 loans. Since the inception of the program, SBA has approved more than 1,386,000 disaster loans valued at some \$25 billion. As of the end of FY 1997, the SBA disaster loan portfolio included more than 285,000 loans worth over \$7.1 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 non-profit 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 Area Offices located in Niagara Falls, New York; Atlanta, Georgia; Fort Worth, Texas; and Sacramento, California.

Summary of OIG Activity / *Disaster Loan Program*

Audits Underway	3
Audit Reports Issued	2
Indictments Resulting from Investigations	11
Convictions Resulting from Investigations	11
Investigations Closed / Remaining Inventory	10 / 88
Investigations : Restitutions / Fines / Other Recoveries	\$461,018 / \$70,250 / \$0
Investigations: Declination of Loans Due to Name Checks	19 / \$1,253,197
Investigations: Cases Referred to Other Agencies	2
Reviews of Proposed Regulations	1
Reviews of Other Issuances	1

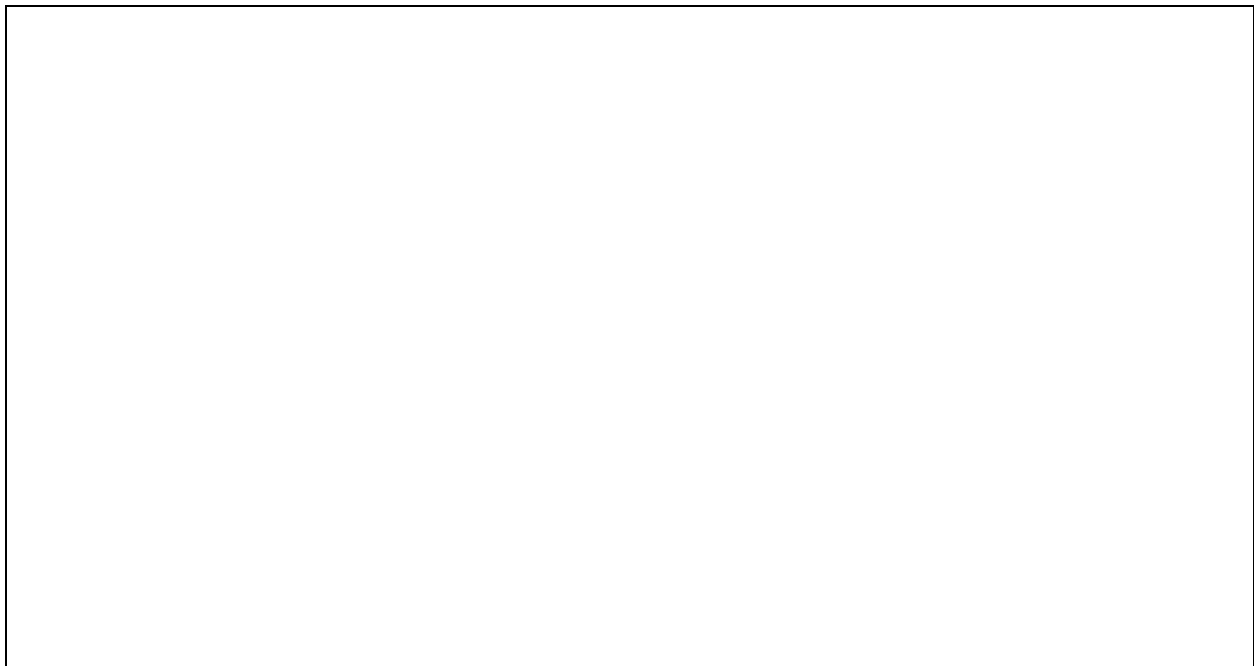


Figure 2

Efforts to Improve SBA Program Management

Audit Supports SBA's Non-Use of the Credit Alert Interactive Voice Response System (CAIVRS)

OMB Circular A-129 requires Federal credit agencies to use the CAIVRS system to test loan applicants for delinquent Federal debt; the existence of such debt would, as a matter of SBA policy, bar applicants from obtaining new loans. SBA's disaster loan program officials have not used CAIVRS because they believe it duplicates credit bureau information and its data is difficult to verify with creditor agencies. Moreover, its use adds too much time to loan processing. An OIG audit confirmed the Agency's position; namely, that commercial credit bureau information is now more complete and usable and using CAIVRS would not be beneficial.

To determine the number of disaster loans made to ineligible applicants, OIG auditors used CAIVRS to review a sample of FY 1995 disaster loan cases and found that .4 percent of borrowers appeared to have outstanding delinquent debt with other Federal agencies. Verification of these matches with those Federal agencies revealed, however, that 37 percent of the CAIVRS matches were not valid. The auditors also tested 600 disaster loan applications in process during April and May 1997 and found that 10 of the borrowers had a record in CAIVRS. The same information on eight of the ten, however, was also available from commercial credit reports which were more readily accessible when compared to the

lengthy CAIVRS verification.

As a result of the audit, the Inspector General wrote to the Acting Deputy Director for Management, Office of Management and Budget, and recommended the elimination of the CAIVRS requirement for SBA's disaster assistance program. His letter stated: "The OIG has concluded that there would be no significant benefit in using CAIVRS as part of the applicant screening process, particularly with the requirement, under the Debt Collection Improvement Act of 1996, that agencies report all delinquencies to commercial credit bureaus."

Audit Finds that Disaster Home Loan Processing Complies with Regulations

An audit issued during the reporting period found that disaster home loan processing was **generally consistent with regulations**. About 91 percent of disaster home loan approvals were consistent with SBA regulations and procedures; the other 9 percent (14 out of 150 in the audit sample) lacked support for repayment ability, credit worthiness, or other eligibility criteria. Disaster field office managers attributed the approval errors to limited training and experience and to policy imperatives on loan processing speed. The Associate Administrator for Disaster Assistance (AA/DA) disagreed with the audit error rate. Based on his review of the loans cited in the audit, he concluded that only six were erroneously approved.

The audit was based on a sample of 150 loans out of a universe of 191,169 disaster

home loans (totaling \$4.7 billion) approved from October 1991 through September 1995. The error rate of 14 loans projected to an estimated 7,811 loans totaling \$175 million in the universe. Borrower cancellations reduced this estimate to \$114 million projected to have been disbursed for loans without required documentation, and another \$14 million can be projected for charge-offs.

The audit recommended that the AA/DA (1) ensure that loan officers receive adequate training, (2) determine a realistic time frame for processing loans, and (3) establish baseline goals for approval processing errors. The AA/DA disagreed with the second recommendation saying that the processing time goal is an external policy decision that the program officials must attempt to carry out and that there was no empirical evidence that such goals caused any level of error rate. He disagreed with the third recommendation saying that the program was taking appropriate steps to reduce processing errors and that establishing a goal for processing errors in this program was impractical.

Activities to Enhance Fraud Detection and Deterrence

Latest Results from Affirmative Civil Enforcement (ACE) Program

Over this reporting period, the OIG's participation in the Department of Justice's ACE program produced 12 successful disaster loan cases, resulting in \$60,000 in civil penalties. These cases involved fraudulent representations (primarily bogus

tax returns) intended to mislead SBA into making disaster loans that should have been declined. Interestingly, half of these loans were stopped before any funds were disbursed and the balance were never fully disbursed by SBA.

California Video Store Owner/Jeweler Pleads Guilty to Filing False Claim

The owner of a Norwalk, California, jewelry shop pled guilty to one count of **filing a false claim** with SBA. After a Los Angeles videotape rental store which she owned was looted and burned during the 1992 civil unrest, the woman was approved for SBA disaster loans totaling \$185,000 to rehabilitate that business. The OIG's investigation revealed that, as part of the loan application, she submitted a copy of a fictitious 1989 individual income tax return and an altered copy of her 1990 individual income tax return. Both of these documents significantly overstated her income. The investigation also revealed that, instead of using the \$159,700 of loan proceeds to reopen the video store, she chose to open a jewelry store. (SBA canceled the final loan disbursement of \$25,300.) The investigation was initiated based on referrals received from SBA's Fresno district counsel and Disaster Assistance Area 4 Office.

Texas Automobile Repair Shop Owner Sentenced for Making False Statements

The owner of a Fort Worth, Texas, auto repair shop was sentenced to \$29,400 restitution and 5 years probation. He had previously pled guilty to one count of **making false statements to SBA**.

Following a December 1991 flood, he had received three disaster loans: a \$16,800 home loan, a \$16,700 business physical damage loan, and a \$12,700 economic injury loan. In applying for these loans, the recipient reported owning \$39,000 in stocks and bonds that he knew he did not own. While the home loan is current, the two business loans are in repayment default. This was a joint investigation by the OIG and the U.S. Secret Service. It was opened in response to a referral from SBA's Disaster Assistance Area 3 Office.

Missouri Consultant Pleads Guilty to Making Material False Statements

A Cuba, Missouri, industrial construction consultant pled guilty to one count of **making material false statements** to obtain SBA disaster assistance. In support of the loan application, he submitted three fictitious tax returns for a St. Louis business that he had purchased subsequent to the disaster and which received SBA disaster loans totaling \$407,800. The OIG initiated the investigation based on information from an anonymous source.

Nebraska Loan Guarantor Pleads Guilty to Making False Statement

A guarantor of economic injury and physical damage disaster loans received by a Plattsmouth, Nebraska, resort pled guilty to one count of **making a false statement to SBA**. A joint investigation by the U.S. Secret Service and the SBA/OIG had shown that the man defrauded SBA by submitting a false invoice regarding use of the loan proceeds. The resort, which featured camping, fishing, and swimming,

received SBA disaster loan proceeds totaling \$206,400 following the 1993 flood of the Platte River; it has made no repayment to SBA. This investigation was based on a referral from SBA's Omaha District Office.

California Nurse Registry Owner Indicted for Filing False Claim and Making False Statement

The owner of a nurse registry in Los Angeles, California, was indicted on one count of **filing a false claim** with SBA and one count of **making a false statement to a Federally-insured lender**. The OIG investigation, based on a referral from SBA's Disaster Assistance Area 4 Office, found that the man submitted fraudulent applications for disaster-related business loans to a bank and SBA. He obtained a \$50,000 bridge loan from the bank and subsequently received an \$89,600 economic injury loan and a \$72,800 physical damage loan, respectively, from SBA. In each of the loan applications, the owner claimed his business was located in a building that had been damaged by fire during the 1992 civil unrest in Los Angeles. The investigation disclosed, however, that his business sustained no damage whatsoever because he actually operated the nursing service out of his personal residence. Allegedly false documents which he submitted with the loan applications include a lease, a telephone installation invoice, and an estimate of the cost of replacing his business' files. The SBA disaster loans went into default early, and SBA charged off both loan balances in 1993. The business owner did not make any payments on the bridge loan; consequently, the bank

charged it off in 1994.

California Disaster Home Loan Recipient Pleads Guilty to Making False Statements to Government Agencies

A Mission Hills, California, disaster home loan recipient pled guilty to one count each of **making a false statement to SBA** and **making a false statement to the Federal Emergency Management Agency (FEMA)**. The SBA/OIG's joint investigation with the FEMA/OIG, opened in response to a referral from SBA's Santa Ana Servicing Center, revealed that he had submitted three disaster home loan applications--two were submitted using fictitious names and all three contained false claims for damages from the 1994 Northridge earthquake. A total of \$27,000 was disbursed in connection with the first two loans, and both loans defaulted without a single payment having been made. The third loan, for \$113,000, was approved but not disbursed because SBA's Disaster Assistance Area 4 Office detected inconsistencies in the loan application's documentation.

California Disaster Loan Recipient Indicted for Making False Statements

The former owner of a fashion outlet located in Los Angeles, California, was indicted on one count of **making a false statement** to SBA. The OIG initiated the investigation based on a referral from SBA's Santa Ana Servicing and Liquidation Center and continued it jointly with the U.S. Secret Service. Following the 1992 civil unrest, the businessman had obtained two SBA disaster assistance

loans. The investigation found that, in support of his applications for a \$87,300 physical damage loan and a \$28,100 economic injury loan, the applicant had submitted copies of tax returns which had been altered to overstate his income. The investigation established that the disaster assistance loans would not have been made had his true financial condition been known; his alleged fraudulent activity resulted in a \$77,000 loss to SBA.

Texas Businessman Pleads Guilty to Three Counts of Forgery

The owner of a Clute, Texas, computer services company pled guilty to three counts of **forging endorsements on U.S. Treasury checks** which represented a portion of the proceeds of a \$183,400 economic injury disaster loan his business had obtained from SBA. The man fraudulently negotiated three Treasury checks (totaling approximately \$27,000), each jointly-payable to the applicant's business and another business whose endorsement was falsely made. His indictment resulted from an OIG investigation based on a referral from SBA's Houston District Office.

Mississippi Couple Indicted on Variety of Fraud Charges

A husband and wife who owned an auto parts franchise in New Hebron, Mississippi, were indicted on seven counts of **making false statements, filing false claims, possessing documents used to defraud the Government, and conspiracy**. Their company obtained a \$120,000 SBA-guaranteed loan in 1991; it

also received a \$42,500 physical damage loan and a \$29,800 economic injury disaster loan in 1992. An investigation by the OIG found that the couple used fraudulent receipts and invoices to conceal their misuse of proceeds of all three SBA loans. The indictment also charges that their loss claims were false. The investigation was based on a referral from SBA's Jackson District Office.

California Pharmacist Pleads Guilty to Making False Statement

The former owner of a pharmacy in Sherman Oaks, California, pled guilty to one count of **making a false statement** to SBA. Based on a referral received from the Santa Ana Disaster Loan Servicing and Liquidation Center, an investigation was initiated into allegedly false financial information given to SBA in support of three disaster loans. The pharmacist had received a \$100,000 disaster home loan following the 1993 severe winter storms and a \$45,000 disaster home loan, as well as a \$218,000 disaster business loan, following the 1994 Northridge earthquake. In 1996, he requested that SBA release its lien on his business assets. Information supporting the request contradicted information in his loan applications, and the investigation revealed that he had given SBA fictitious Wage and Tax Statements (Form W-2), altered Individual Income Tax Returns, a fictitious S Corporation Income Tax Return, and a fraudulent Corporation Profit and Loss Statement.

Results of Previously Reported Investigations

North Carolina Disaster Home-Loan Recipient Sentenced for Making False Statements

A Waynesville, North Carolina, woman was sentenced to 1 year in prison and 3 years supervised release. She had pled guilty to two counts of **making false statements** to obtain a \$38,400 SBA disaster home loan. To secure SBA's approval of her loan application and a disbursement of the initial \$10,000 of the loan, she submitted a deed of separation from her husband, which had been altered to significantly overstate her alimony income, as well as other falsified documentation.

Georgia Equestrian Center Owner Sentenced for Perjury

The president of a Unadilla, Georgia, horse-show arena was sentenced to 15 months imprisonment and 3 years supervised release. He had been convicted on two counts of **perjury**. The charges related to his testimony that his signature had been forged on a personal guaranty submitted to obtain an SBA economic injury disaster loan. The OIG's investigation determined that the signature was not a forgery.

California Store Owner Sentenced for Making False Statement

The former owner of a TV and VCR repair shop in Los Angeles, California, was sentenced to 6 months home detention, 5 years probation, and \$37,918 restitution to SBA. He had pled guilty to one count of **making false statements** to SBA. The

man had filed for bankruptcy under several SSNs and concealed the bankruptcy filings from SBA to obtain two disaster loans totaling \$39,700 for his business following the 1992 civil unrest. He also submitted altered copies of income tax returns in support of his loan applications.

California Disaster Loan Recipient Sentenced for Making False Statement

A Northridge, California, resident was sentenced to 2 years probation, 100 hours community service, and a \$5,000 fine for **making a false statement** to SBA. He had been approved for a \$123,100 disaster home loan following the 1994 earthquake.

The man requested that SBA reduce his monthly payments because his financial condition had worsened as a result of a new \$20,000 installment debt incurred with the purchase of a 1994 Acura automobile. The OIG's investigation revealed, however, that he had paid cash for the vehicle!

California Tax Preparer Sentenced for Making Material False Statements

A tax preparer in Glendale, California, was sentenced to 3 years probation, 400 hours community service, and a \$5,000 fine. He had pled guilty to aiding and abetting the **making of material false statements** by preparing altered income tax returns which were submitted to SBA in support of a \$450,000 economic injury disaster loan application. The tax preparer significantly overstated the incomes of both the applicant company and its owner.

Arizona Businessman Sentenced for Forgery

The owner of a now-defunct machinery company in Buckeye, Arizona, was sentenced in Arizona Superior Court to 3 months imprisonment, 4 years probation, and \$383,700 restitution to SBA. He had pled guilty to one count of **forgery**. The investigation revealed that the man had forged his estranged wife's signature on numerous disaster loan documents to obtain a \$56,100 business physical disaster loan and a \$327,600 economic injury disaster loan.

St. Croix Resident Sentenced for Making False Statements to SBA

A resident of St. Croix, U.S. Virgin Islands, was sentenced to 21 months imprisonment and \$10,000 restitution to SBA. He had pled guilty to one count of **making false statements to SBA**. The investigation developed evidence that the man's application for a \$10,000 disaster home loan contained false claims for lost property, a false bill of sale for an automobile, and falsified property rental agreements.

California Restaurant Owner Pleads Guilty to Making False Statement and Fraud

The former owner of a restaurant in Compton, California, pled guilty to one count of **making a material false statement** to SBA and one count of **fraudulent use of a Social Security number** (SSN). The OIG's investigation disclosed that his application package included a fictitious individual income tax return and an SBA Form 413, Personal Financial Statement, that overstated his

income. He used an SSN that was not his on those documents, as well as on his SBA Form 912, Statement of Personal History.

Small Business Investment Companies

The primary purpose of the Small Business Investment Company Program is to provide a source of long-term debt and equity capital to new or expanding small businesses. **Small Business Investment Companies (SBICs)** are independently-owned and managed, profit-making investment companies which are licensed by SBA to finance small businesses 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 (a) to determine which SBICs to license, (b) to oversee and regulate those licensees, and (c) to arrange for Government-guaranteed financing from private sources to add to their capital. Such financing, termed "leverage," is provided through either debentures or participating securities issued by the SBIC. The participating security was created by the Small Business Equity Enhancement Act of 1992 to serve the needs of SBICs investing principally in equity securities which do not generate sufficient income to cover the interest on their debenture leverage. They represent a limited partnership interest in the SBIC, whereby SBA advances the cost of the leverage until profits have been generated from the SBIC's equity investments. In consideration, SBA participates in approximately 10 percent of the SBIC's profits. The Agency arranges quarterly public offerings of trust certificates which are backed by pools of SBIC debentures or participating securities which SBA guarantees as to the payment of principal and interest.

As of the end of FY 1997, there were 300 licensed and active SBICs, with a total capitalization of \$6.7 billion (private capital of \$5.1 billion and leverage of \$1.6 billion). Included are 80 Specialized SBICs (SSBICs) which were licensed under Section 301(d) of the Small Business Investment Act to invest only in small businesses owned and managed by socially or economically disadvantaged persons. (Section 301(d) was repealed in 1996, but existing SSBICs were "grandfathered" and continue to operate as before.) I At the end of FY 1996 there were 160 SBICs in liquidation owing SBA \$302 million. While the SBIC program level in FY 1997 was \$667 million, the FY 1998 program level will be \$832 million, signaling a continuing expansion of the program.

The SBI Act generally requires that all SBICs licensed by SBA be examined every 2 years to ensure licensee compliance with law and Agency regulations. The Small Business Credit and Business Enhancement Opportunity Act of 1992 transferred the responsibility

for examining SBICs from the OIG to the Agency effective October 1, 1992. While SBA's Investment Division is now responsible for these examinations, the OIG continues to have authority to audit the SBIC program pursuant to its responsibility to oversee all Agency programs and activities.

Summary of OIG Activity / *Small Business Investment Companies*

Indictments Resulting from Investigations	6
Investigations Closed / Remaining Inventory	0 / 13
Investigations : Restitutions / Fines / Other Recoveries	\$20,000 / \$0 / \$1,127,000
Reviews of Proposed Regulations	3
Reviews of Standard Operating Procedures	3



Figure 3

Efforts to Improve SBA Program Management

Major CPA Firm Pays SBA \$6.1 Million to Resolve Defective SBIC Audits

A major CPA firm agreed to pay \$6.1 million to settle allegations that its inadequate audits contributed to SBA's losses when an SBIC failed. The SBA claim against the independent auditors centered on the SBIC's failure to disclose risky participation agreements in its financial statements. Participants were guaranteed their share of loan payments whether or not the borrower actually paid, and the participants could also "put" their investment back to the SBIC on short notice. Under generally accepted accounting principles, such practices should have been disclosed in the company's financial statements but were not. Thus, the auditors **incorrectly certified that the financial statements fairly presented the SBIC's financial condition.**

When the SBIC declared bankruptcy in 1990, SBA had \$27.5 million invested in leverage. One third of the leverage was invested after the SBIC increased its participation agreements to a material amount in 1987.

After a review of the audit firm's working papers by the OIG's Auditing Division, SBA's Office of General Counsel and the Department of Justice (DOJ) alleged that the audit firm was negligent in its audits. The DOJ accepted the case and represented SBA in an arbitration proceeding. The arbitration panel ruled that the audit firm

was liable for negligence, but it declined to set damages because of insufficient information. The parties then negotiated the \$6.1 million settlement that was concluded in June 1997.

Program Vulnerability Memorandum Issued on Reporting of Criminal History Information by SBIC Officers

In June 1997, the Inspector General issued a program vulnerability memorandum (PVM) to the Associate Administrator for Investment (AA/I). According to the PVM, a recent OIG investigation had revealed an Agency vulnerability regarding the **timely disclosure of criminal history information by SBIC officers.** The vulnerability had delayed and almost prevented the Agency from learning about an SBIC president's use of a firearm to intimidate a borrower and Federal examiners.

The investigation corroborated a borrower's allegation that the SBIC's president brandished a pistol intimidating him, his attorney, and his fiancée during a February 1996 SBIC loan closing. The investigation disclosed that the SBIC's president had also flashed a gun before two U.S. Securities and Exchange Commission examiners during a June 1995 examination of the SBIC. The SBIC's president was arrested for the 1996 incident and charged with "Menacing" in the second degree; he subsequently pled guilty to a lesser charge of second degree "Harassment," and was sentenced to a "Conditional Discharge." Charges were not filed for the 1995 incident.

The Agency did not become aware of the SBIC president's misconduct until a complaint was lodged by a borrower. Under the present regulations, applicants for SBIC licenses must submit to the Agency a completed SBA Form 415A, Statement of Personal History and Qualifications of Management, which asks among other things whether the applicant has ever been charged with or convicted of any criminal offense other than a misdemeanor involving minor motor vehicle violations. Once an SBIC is licensed, only subsequently elected or appointed officers of the licensee must submit a Form 415A. After these initial submissions, SBIC officers are not required to advise the Agency of any criminal charges filed against them. Consequently, the Agency had no means of knowing if an SBIC officer had ever been arrested or charged with a serious crime since the time of the original application. An SBIC could, therefore, have been managed for years by one or more officers with criminal records without the Agency's knowledge. This situation could pose a needless threat to both borrowers and Government examiners. Moreover, Government funds could be placed in jeopardy and the public's perception of the Agency damaged.

The OIG recommended that SBIC officers be required to notify the Agency whenever they are charged with a criminal offense, other than a misdemeanor involving minor motor vehicle violations. Such notification could be given (1) within 10 days from the date of the arrest or filing of charges, (2) during the annual examination, or (3) in response to a question in the SBIC's

required yearly submissions. Proposed regulations requiring an SBIC to "notify SBA if an officer, director, general partner, or other Control Person is charged with, or convicted of, any criminal offense other than a misdemeanor involving a minor motor vehicle violation" were published in the Federal Register on October 14, 1997.

Activities to Enhance Fraud Detection and Deterrence

Leaders of Incorporated New York State Village Indicted for Conspiracy, Embezzlement, Fraud, and Money Laundering

A 21-count indictment of six men from an incorporated village in Rockland County, New York, was unsealed on May 28, 1997. The indictment charged the men with participating in a number of fraudulent schemes to obtain tens of millions of dollars through the Specialized Small Business Investment Company (SSBIC) program and other Federal, State grant, loan, and subsidy programs. The charges, all relating to the incorporated village, include **conspiracy, embezzlement of Federal program funds, making false statements, mail fraud, wire fraud, mortgage fraud, and money laundering.**

One man was a member of the board of directors of the SSBIC, a wholly-owned subsidiary of a local development corporation (LDC); a second man was a member of the board of directors of the LDC; and four other alleged co-conspirators were affiliated with other entities related to the village. The indictment charged the first man with misappropriating SBA funds through the SSBIC, in which SBA had invested \$1

million. In violation of Federal regulations, he is alleged to have participated in extending loans to small businesses affiliated with the SSBIC's officers and directors, and concealing these improper loans by submitting fraudulent documents to SBA. He is also accused of loaning SBA funds to enterprises that were not independently controlled by private business-owners but affiliated with a religious school in the village, a not-for-profit entity that was ineligible to receive SBA funds. The SSBIC also allegedly loaned money to small businesses that, in turn, improperly paid a portion of the loan proceeds to the religious school or to related entities. The other defendants allegedly conspired to facilitate these illegal transactions. The office of the U.S. Attorney for the Southern District of New York asked the SBA/OIG to join its ongoing investigation with the IRS and the OIGs of the Departments of Education and Housing and Urban Development.

case was initiated after allegations of wrongdoing were received from the SSBIC's investment advisor, an individual who had been placed in that position by SBA to monitor the company's operations.

The investigation disclosed that the man made false statements concerning the amount of money he had invested in the SSBIC; he also misapplied more than \$400,000 by pledging company assets for his personal enrichment. To conceal his illegal activities, he falsely reported in the SSBIC's records that loans totaling at least \$337,500 had been repaid. In 1987, the SSBIC was placed in receivership by SBA, and the Agency subsequently obtained a civil judgment in excess of \$5 million against the company and its president. Unfortunately, SBA ultimately suffered a loss of more than \$3.4 million because of these actions.

Results of Previously Reported Investigations

Korean Businessman in California Sentenced for Misapplication of SBIC Funds

A Korean national who had been president and majority shareholder of a now-defunct SSBIC in Los Angeles, California, was sentenced to 6 months home detention, 5 years probation, and \$20,000 restitution to SBA. He had pled guilty to four felony counts of **misapplication of funds of a small business investment company** following a lengthy investigation which the OIG conducted jointly with the FBI. The

Surety Bond Guarantees

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

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

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

SBA can guarantee bonds for contracts with a face value of up to \$1.25 million. In FY 1997, SBA contingent liability for new final bond guarantees, including those issued under the PSB program, was \$615 million. The appropriated guarantee authority level for FY 1996 surety bond guarantees was \$1.767 billion; in FY 1997, it was \$1.767 billion.

Summary of OIG Activity / Surety Bond Guarantees	
Audits Underway	1
Audit Reports Issued	1
Investigations Closed / Remaining Inventory	1 / 1
Investigations: Declination Due to Name Check	1



Figure 4

Efforts to Improve SBA Program Management

Audit Uncovers Non-Compliance with SBA Underwriting Standards at a Maryland Surety

After an audit revealed **non-compliance with SBA regulations and underwriting standards**, a Maryland surety company withdrew claims for \$934,492 on two defaulted surety bonds. Both bonds were written after work had started, a violation of SBA regulations. One bond was issued without an evaluation of reasonableness of

cost and feasibility of successful completion, as required by the underwriter's own standards. The contractor had no experience in the type of contract and grossly underbid the project. The OIG audit recommended that SBA cease payments on the two claims and recover \$866,942 already paid to the firm. The Associate Administrator for Surety Guarantees concurred with the audit recommendations.

Surety Bond Guarantee Program SOPs Reviewed

As part of SBA's initiative to update and streamline its SOPs, the OIG reviewed proposed revisions to two SOPs. Its review of SOP 50 45 2, **Surety Bond Guarantee Program**, called for clarifying when certain SBA forms are required for both initial and subsequent applications from the same contractor, adding more guidance for on-site reviews of sureties, and making changes to procedures for referral of suspected irregularities to the OIG. After reviewing SOP 50 46 1, **Claims and Recovery**, the OIG suggested that a clarification be added to the discussion of appropriate actions where an actual breach of contract has not yet occurred.

Government Contracting Programs

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

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 assure that small business concerns, especially those new to the Federal procurement market, are given a fair opportunity to compete for and win Government contracts. If a small business is the 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.

The **Procurement Marketing Access Network (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 and large prime contractors both use as PRO-Net a resource in identifying small businesses for procurement opportunities. Small businesses use this interactive

mechanism to market their products and services.

Summary of OIG Activity / Government Contracting	
Investigations Closed / Remaining Inventory	0 / 5
Investigations : Restitutions / Fines / Other Recoveries	\$0 / \$0 / \$300,000
Reviews of Proposed Legislation	1
Reviews of Other Issuances	3

Activities to Enhance Fraud Detection and Deterrence

Largest Government Contracting Result from Affirmative Civil Enforcement (ACE) Program

During this period, the OIG's participation in the Department of Justice's ACE program produced the best results (a cash settlement) to date in the Government Contracting program. An OIG investigation documented that a Government contractor **falsely certified that the company was a small business** to obtain ten awards of procurement contracts reserved for small businesses. While denying any allegation that it knowingly submitted a false size certification, the company agreed to pay SBA \$300,000 to resolve its potential liability under the False Claims Act. The OIG initiated the investigation in response to an anonymous complaint.

Please Note:

On April 10, 1997, the Inspector General testified before the U.S. Senate Committee on Small Business on the ability of SBA to

implement the HUBZone Act of 1997. The Act is intended to provide Federal contracting opportunities for small business concerns located in historically underutilized business zones. Because the testimony also included extensive comments pertinent to the Minority Enterprise Development (MED) program, a summary description of the testimony is presented in the MED chapter.

Minority Enterprise Development

Section 7(j)(10) of the Small Business Act established the **Minority Small Business and Capital Ownership Development Program** for the purpose of promoting greater access to the free enterprise system for socially and economically disadvantaged individuals. Under the Act, SBA provides business development assistance to small business concerns that are at least 51 percent unconditionally owned, controlled, and managed by one or more socially and economically disadvantaged individuals and also meet 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, 1997, there were more than 5,570 approved program participants. In FY 1997, Section 8(a) program participants received 4,733 contracts and 24,026 modifications with an aggregate value of \$5.6 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 Minority Enterprise Development, SBA provides specialized training, professional consultant assistance, and executive development to certified Section 8(a) firms, socially and economically disadvantaged individuals whose firms are not participants in the Section 8(a) program, low-income individuals, and small businesses located in areas of low income or high unemployment.

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

Summary of OIG Activity / Minority Enterprise Development	
Audits Underway	3
Investigations Closed / Remaining Inventory	0 / 9
Investigations: Cases Referred to Other Agencies	1
Investigations: Declinations Due to Name Check	11
Reviews of Proposed Regulations	1
Reviews of Other Issuances	8

Inspector General Testimony Before the U.S. Senate Committee on Small Business Concerning the HUBZone Act of 1997

On April 10, 1997, the Inspector General testified before the U.S. Senate Committee on Small Business on SBA’s perceived ability to implement the HUBZone Act of 1997. The Act is intended to provide Federal contracting opportunities for small business concerns located in historically underutilized business zones. The Committee specifically requested the Inspector General to comment on the success and failure SBA has experienced in running its Section 8(a) program. The Inspector General was also asked to comment on the Agency’s stewardship of the Section 8(a) contract assistance program and whether the program is truly meeting its public policy purpose.

The Inspector General listed eight specific concerns with the HUBZone Act of 1997, as contained in S. 208. Specifically:

1. Language was needed to ensure that HUBZone companies do not broker contracts.

2. Clear size standards should be added.
3. The term “principal office” needed to be defined.
4. Criteria were needed so SBA would be able to determine how to calculate the percentage of employees that must live in the designated HUBZone.
5. Clarifying language should require SBA to verify each company’s initial and continuing eligibility to participate in the program, specifying the verification method, and how often verifications must be conducted.
6. Language needed to be added ensuring that SBA will take swift and final action to terminate all companies that falsify data for purposes of entering or remaining in the program.
7. Language should define who is an “interested party” for protest purposes.
8. A cap should be placed on the dollar value of any sole source

contract received by a participating HUBZone company.

In the Inspector General's judgment, SBA lacked sufficient staff resources to implement the act's requirements successfully.

Commenting on SBA's stewardship of the Section 8(a) program, the Inspector General stated that while SBA had implemented a limited number of changes in an effort to administer the Section 8(a) program more equitably, the Agency continued to have difficulty managing the program. Much of the difficulty could be traced to:

1. SBA's reluctance to place dollar limits on various criteria used to judge whether participants should continue in the program.
2. Its continued use of overly generous net worth limits.
3. The retention of regulations which constrained SBA officials from completing needed actions expeditiously.
4. Inexplicable delays in taking corrective actions, e.g., a graduation letter being "lost" within SBA and no resolution of the company's status for almost 4 months.
5. The ineffective enforcement of regulations and SOPs that would correct some of the program's deficiencies.

The Inspector General suggested that a pilot HUBZone be implemented for a 2 to 3 year period in a carefully selected,

limited number of rural and urban underutilized business zones, and that Congress provide the necessary funds for SBA to effectively manage the proposed pilot program. Results could then be compared with the Department of Commerce's Empowerment Contracting Program, and Congress could take the best from each initiative to fashion an economic opportunity program that might better serve rural and urban areas needing such Federal assistance. Finally, he urged the SBA Administrator to take decisive action to improve SBA's management of the Section 8(a) program.

Minority Enterprise Development Program Regulations Reviewed

The OIG reviewed a final draft of the proposed amendments to 13 C.F.R. Part 124, governing the MED program, and provided numerous comments to the Agency for its consideration in developing new regulations. The OIG's comments focused on such issues as evidence of social disadvantage, determinations of economic disadvantage, net worth limits, the 2 year business experience rule, brokers' participation in the program, the non-manufacturer rule, graduation experience, termination proceedings, transfers and withdrawals of business assets, sole source contracts, competitive mix requirements, joint ventures, Section 8(a) sole source contracts, subcontracting limitations, and small disadvantaged business private certifiers and the certification process.

Economic Development (Business Information Education and Training)

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

The **Service Corps of Retired Executives (SCORE)** is another of the valuable business development resource partners of SBA. Composed of approximately 12,400 volunteers working in over 700 sites, SCORE provides counseling and training to current or prospective business persons. These sessions are free to the public, and formal training is provided at a low cost. Over 293,000 clients were assisted in FY 1997.

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. **Cosponsorship** arrangements, authorized under the Small Business Act, play a key part in this process; the Act gives SBA the authority to cosponsor training and counseling activities for small business concerns with non-profit entities and/or with other Federal Government agencies. In addition, the Act authorizes the Agency to cosponsor training, but not counseling, with for-profit concerns.

Business Information Centers (BICs) provide business owners with access to computers, software, databases, and other resources to assist them in starting and expanding their businesses. All BICs have at least one on-site counselor and can address the varied business start-up and growth issues encountered by small business owners. There are currently 41 BICs in operation.

Summary of OIG Activity / Economic Development	
Audits Underway	1
Indictments Resulting from Investigations	1
Convictions Resulting from Investigations	1
Investigations Closed / Remaining Inventory	2 / 1
Inspections Underway	1
Reviews of Proposed Regulations	2
Reviews of Standard Operating Procedures	1
Reviews of Other Issuances	1

Efforts to Improve SBA Program Management

Program Vulnerability Memorandum Issued on Program Income and Fiscal Reporting Requirements

On April 2, 1997, the Inspector General issued a program vulnerability memorandum (PVM) to the acting Associate Deputy Administrator for Economic Development (ADA/ED). The PVM pointed out that a recent OIG investigation had revealed a procedural "looseness" that **blurred accountability for the use of SBDC funds**. The PVM suggested a number of procedural changes, including certifications of truthfulness and compliance with the regulations, to introduce more accountability. On April 29, 1997, the acting ADA/ED replied that the OIG's audit and investigation of the SBDC had already:

resulted in significant changes to deter similar occurrences in the future. . .

. [T]he SBDC FY 1998 Program Announcement . . . added a number of additional financial controls to

guard against a recurrence . . . includ[ing] both reporting responsibilities for the SBDCs and increased oversight and monitoring responsibilities for SBA Project Officers.

In an effort to introduce more accountability in the use of SBDC funds, the Office of SBDCs has been working on the revision of the program's Federal regulations and the Program Announcement since the Spring of this year. The Office has scheduled a meeting

with members of the newly appointed Association of SBDCs' Operations Committee during the first week in February 1998 to discuss these revisions. The focus of this meeting will be on the revision of the SBDC Federal regulations and the Program Announcement (the Request for Proposal for the SBDC program) to correct this situation.

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, reviews the Agency's cash management and integrity assurance activities.

SBA's management and financial activities are supported by the Agency's \$852.4 million in operating funds, partially provided by FY 1997 appropriations enacted in P.L. 104-208. Of the \$852.4 million available, which includes carry-overs and estimated recoveries, \$235 million funds Salaries and Expenses, \$22 million is for Disaster loan servicing, and \$86.5 million is for Disaster loan making. In addition, \$277.7 million is available for Business Loans, \$218.4 million for Disaster loans, and \$3.73 million for the Surety Bond Guarantee program.

Summary of OIG Activity / Agency Management and Financial	
Audits Underway	3
Audit Reports Issued	5
Investigations Closed / Remaining Inventory	7 / 18
Investigations: Restitutions / Fines / Other Recoveries	\$7,294 / \$50 / \$0
Inspections Underway	2
Reviews of Proposed Regulations	2
Reviews of Standard Operating Procedures	13
Reviews of Other Issuances	52



Figure 5

Efforts to Improve SBA Program Management

Audit-Related Management Letters Highlight Internal Control Weaknesses

SBA does not have effective procedures for identifying and reporting internal control weaknesses as required by the Federal Managers Financial Integrity Act (FMFIA), according to management letters issued in conjunction with the audit of SBA financial statements for FY 1996. The Computerized Internal Control Review system was canceled by the Agency in February 1996 and a task force formed to establish a "more meaningful review process." The SBA Administrator

announced this summer that the Agency will adopt the internal control standards promulgated by the Committee of Sponsoring Organizations of the Treadway Commission which, when implemented, should bring SBA into compliance with FMFIA and OMB Circular A-123.

Notwithstanding the Agency's first "unqualified" audit opinion of its financial statements, this was one of a number of issues identified in an audit-related management letters to the Chief Financial Officer, the Chief Information Officer, and the Atlanta Disaster Area Office. Other issues concerned verification of field office transactions, documentation of new automated cash reconciliation procedures,

reconciliation of SBIC loan balances, SBIC subsidy rate reestimates, collateral appraisals, debt collection procedures, computer security and training, and ethics program reporting.

Indirect Rates for SBA Contract Questioned by Audit

On June 5, 1997, the OIG issued a Defense Contracting Audit Agency (DCAA) report on an Arlington, Virginia, technology company. The report **questioned the contractor's indirect rates for fringe benefits, office overhead, onsite overhead, and general and administrative expenses** for the 3 year audit horizon (1992-94). DCAA provisionally approved the contractor's direct costs pending final acceptance of the work being completed. Based on the DCAA audit report, the OIG recommended that SBA's Director of Procurement and Grants Management ensure that the contractor's indirect rates reflect those determined to be acceptable by DCAA.

Pre-Award Audit of West Virginia Grantee Finds Unallowable Costs and Depreciation

A pre-award audit of a West Virginia foundation's grant proposal for \$3 million, appropriated under Public Law 104-208, questioned \$463,905 of **proposed costs that were unreasonable or unallowable** and need reprogramming to other allowable cost areas.

In addition, the pre-award audit identified **\$9.7 million in unallowable depreciation** proposed for allocation to Federal grants in

future years. Of this amount, \$4,248,000 related to a building paid for by Federal funds for which depreciation is not allowed. The balance related to a commercially-rented building for which depreciation is also inappropriate, unless the revenue generated is allocated as program income to the Federal grant. The OIG recommended that the foundation prepare a revised proposal which corrected the deficiencies found during the audit. SBA's Assistant Administrator for Administration agreed with the OIG's findings and recommendations.

Agency Management and Financial Activities SOPs Reviewed

As part of SBA's initiative to update and streamline its SOPs, the OIG reviewed proposed revisions to 13 SOPs governing SBA management and financial activities. The OIG provided comments on directives concerning issues such as audit follow-up, budget execution and funds control, disbursement functions, employee development, and travel.

Activities to Enhance Fraud Detection and Deterrence

OIG Conducts Employee Awareness Briefings

In addition to investigating complaints of waste, fraud, and abuse involving SBA programs, OIG Investigations Division staff presented 17 **Standards of Conduct briefings** to some 400 **Agency employees**. The involvement and cooperation of all SBA employees in combating waste, fraud,

and abuse is critical to an effective OIG investigations program and to the Agency's overall productivity and efficiency.

During the reporting period, employee contributions to our mission were significant. As Figure 6 (page 48) shows, nearly half of all investigative referrals came from SBA employees. This cooperation reflects the strong commitment of SBA program managers and employees to reducing waste, fraud, and abuse in the Agency's programs and improving management and control of program delivery.

Results of Previously Reported Investigations

Former SBA Employee Sentenced for Misuse of Social Security Number

A former miscellaneous documents clerk in SBA's Disaster Assistance Area 4 Office (DAO-4) was sentenced to 5 years probation and \$4,794 restitution for **misuse of a Social Security number (SSN)**. The OIG initiated an investigation based on information provided by the DAO-4 that one of its employees had obtained and subsequently misused the SSN of a loan applicant who had the same name. The investigation confirmed that the employee had applied for and received credit and merchandise from four Sacramento-area businesses using the loan applicant's SSN. The retail stores lost a total of \$6,217 as a result of this fraudulent activity.

Former SBA Employee Sentenced for Opening and Using Charge Accounts in Other Employees' Names

A former Minority Enterprise Development technician in SBA's New York District Office (NYDO) was sentenced to 3 years probation and \$2,500 restitution. She had pled guilty to **using unauthorized access devices** (credit cards) in an offense affecting interstate commerce. The investigation disclosed that, over a period of more than 1 year, the technician used her position to obtain the Social Security numbers of at least three current or former co-workers. She subsequently used their names and Social Security numbers to open numerous fraudulent charge accounts and to purchase merchandise valued at over \$3,000.

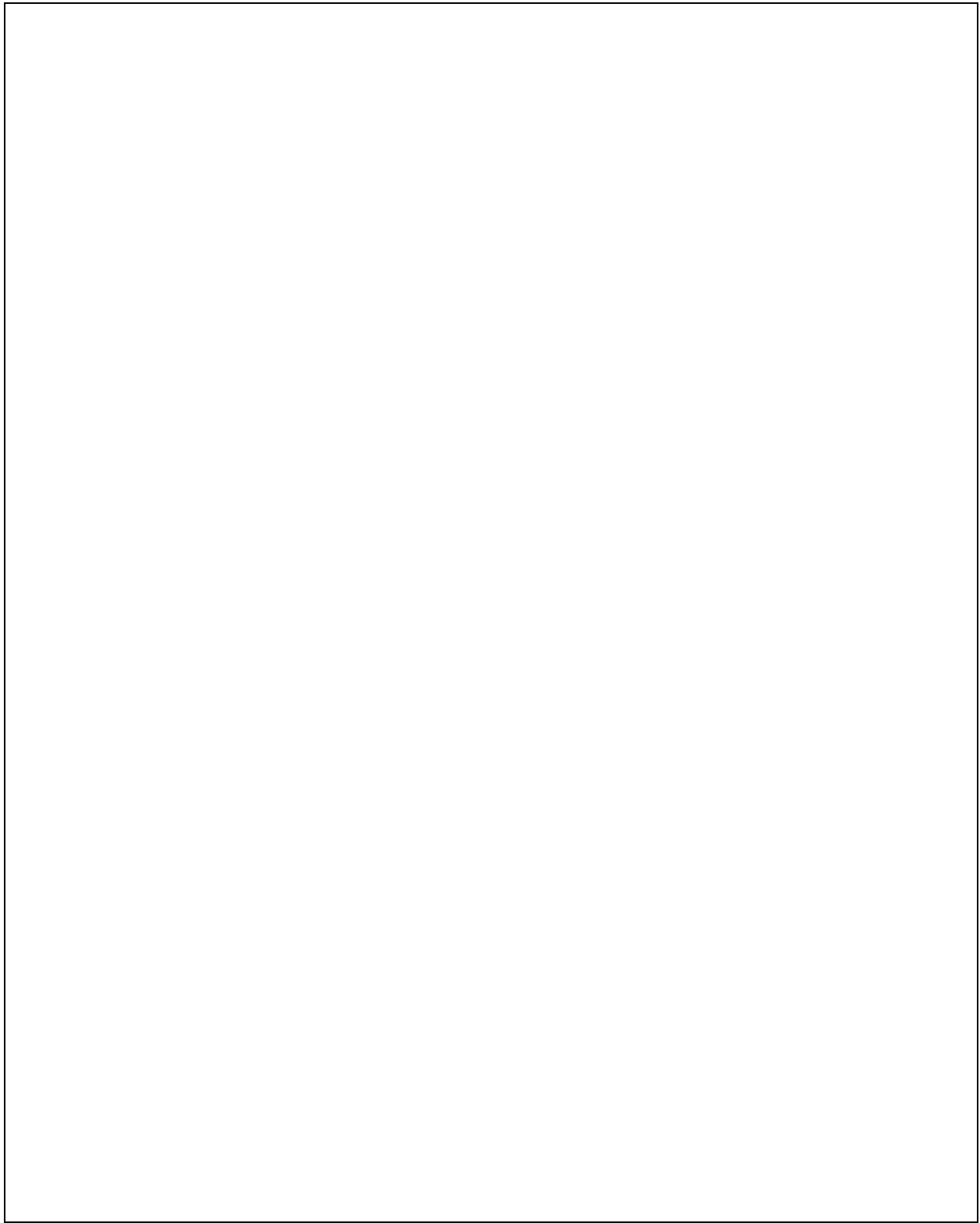




Figure 6

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

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

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

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

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

Resources

In FY 1997, the OIG operated with a funding level of \$9.0 million and an authorized personnel ceiling of 102 full-time equivalent (FTE) positions. While this level of funding represents a modest increase from the number of dollars appropriated in FY 1996, it provides only a minimal level of oversight to SBA programs and program dollars at risk. Congressionally-mandated law enforcement availability pay, annual cost of living increases, and various locality pay adjustments are not fully funded by the OIG's authorized spending levels.



Figure 7

In FY 1994, the 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 (see discussion below). Also, the Congress authorized an FY 1997 transfer of \$500,000 in Agency funds for OIG disaster-related oversight. At the end of the current reporting period, 6 auditors, 5

investigators, 2 attorneys, and 2 secretaries were serving with the OIG on temporary appointments supported by disaster funding. Although the OIG's disaster staffing plan calls for 18 disaster-funded employees, considerable difficulty has been experienced in recruiting, training, and retaining employees serving on temporary appointments.

The nature of the special funding for disaster assistance oversight forces the OIG to pursue recruitment of auditors, investigators, and attorneys on a "non-permanent" basis. These temporary employees are understandably eager to obtain more permanent positions elsewhere, and when they are successful, the OIG is deprived of the expertise they have developed, their productivity, and its investment in their training.

The reduction in OIG FTE resources over the past 5 years remains troubling. As depicted in both Figures 1 and 2 (pages 9 and 22, respectively), the dynamics of the Agency's portfolio, and the concomitant demand for oversight, would suggest that the OIG's resources be increased to ensure an adequate level of program oversight. In recognition of this fact, the President requested \$9.985 million for the OIG for FY 1997, however, the Congress chose to appropriate but \$9 million. The OIG again found it difficult

to carry 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. **Despite the inadequacy of its resources, the OIG, nevertheless, generated a Return on Investment of \$7 to \$1 for FY 1997.** For FY 1998, the President has requested another small increase in the OIG's budget (\$10.6 million) in recognition of SBA's burgeoning portfolio and its mandate to transfer much of its responsibility for portfolio management to the private sector.

The Inspector General continues to be concerned with the strong demand for investigations of fraud in Agency programs. As evidenced by the table on page 53, both business and disaster loan fraud continue to be the OIG's two priorities, in terms of both active cases carried and time expended on these cases. During this reporting period the lion's share of

SBA NEWS RELEASE

Release Date: October 23, 1997

SBA SETS LOAN VOLUME RECORD IN FY 1997, BOOSTS SMALL BUSINESS CAPITAL BY MORE THAN \$13 BILLION

WASHINGTON - The U.S. Small Business Administration (SBA) posted strong gains in its major small business financing programs in the recently completed FY 1997, setting records in total loan dollars, dollars loaned to minority borrowers and venture capital investments, SBA Administrator Aida Alvarez said today. The total for loans and venture capital financing exceeded \$13.25 billion.

"The SBA's accomplishments this past year have helped tens of thousands of Americans start or expand their small businesses," Administrator Alvarez said. "This record reflects the Clinton Administration's ongoing commitment to a growing economy and the President's awareness that small businesses make up the sturdy foundation for that growth. Since the end of fiscal year 1992, the SBA has backed more than \$48 billion in loans to small businesses, more than was accomplished in the previous 12 years combined."

For FY 1997 (ending Sept. 30, 1997), the SBA approved 45,288 loan guaranties amounting \$9.46 billion in the 7(a) General Business Loan Guaranty program, a 23 percent increase in loan dollars from FY 1996. SBA also approved 4,131 loans worth \$1.44 billion under the Certified Development Company (CDC) loan program. The combined dollar amount of \$10.9 billion is a record, exceeding the previous mark of nearly \$10.2 billion set in FY 1996.

investigative time (79.7 percent) was expended on business and disaster loan fraud cases. With demand for SBA business and disaster loans remaining high, it is expected that the bulk of the OIG's investigative efforts will continue to be devoted to these two programs, stretching resources severely.

The table on page 53 also illustrates the Auditing Division's emphasis on the business loan and disaster assistance programs, as reflected in the increase in the time spent reviewing the disaster assistance program. Available audit hours devoted to disaster assistance has grown from 3 to 16 percent over the last 7 reporting periods. The Inspector General is, of course, also concerned by the modicum of coverage the OIG is able to provide to other Agency programs, supporting operations, and program participants. There has been only minimal audit oversight of the Agency computer systems, and the OIG has been virtually unable to respond to specific Agency requests for other program audit coverage. Key programs such as Section 8(a) have also received only minimal audit oversight coverage over the past year, and other programs such as Small Business Investment Companies, International Trade, Micro-Loans, etc., have also received only a modicum of OIG oversight.

Management Initiatives

OIG Annual Training Conferences

The OIG conducted its **annual training session for its administrative support**

personnel in New Orleans, Louisiana, during the week of June 9, 1997. There were 19 attendees who received training in database management software, communications skills, and procurement and budget procedures. The Inspector General also addressed the conferees and presented the Management Support Employee of the Year award.

The OIG also conducted its **annual training conference for professional personnel** in San Diego, California, during the week of July 21, 1997. SBA Administrator Aida Alvarez addressed the attendees during a general session and highlighted the productive and cooperative working relationship which has developed between the OIG and the Office of the Administrator. She also discussed her vision for SBA and a variety of new Agency initiatives.

A wide variety of professional development training was provided to the attendees at the July meeting, including interviewing techniques and defense tactics/firearms (investigators); quantitative analysis and risk assessment (auditors and inspectors); and courses in interpersonal skills, ethics, time management, and CPR. The Inspector General's "state of the office" address to the staff included a summary of the OIG's accomplishments for the year. The SBA Administrator joined the Inspector General for the presentation of awards to the OIG's professional cadre.

The Office of Inspector General notes with deep sorrow the passing of Michael Stansberry, supervisory auditor in its Dallas field office. Mike was respected and admired by his many friends and colleagues in the OIG. We will miss him.

**Direct Investigation Time by Program Area
April 1, 1997, to September 30, 1997**

Program Area	Direct Time %	Number of Investigations	
		Closed	In Progress
Business Loans	58%	25	150
Disaster Loans	22%	10	88
SBIC	5%	0	13
Surety Bond Guarantees	1%	1	1
Government Contracting	*	0	5
Minority Enterprise Development	2%	0	9
Economic Development	1%	2	1
Agency Management and Financial	11%	7	18
Total	100%	45	285

**Direct Auditing Time by Program Area
April 1, 1997, to September 30, 1997**

Program Area	Direct Time %	Number of Audits	
		Issued	In Progress
Business Loans	46%	7	16
Disaster Loans	16%	2	3
SBIC	0%	0	0
Surety Bond Guarantees	3%	0	1
Government Contracting	0%	0	0
Minority Enterprise Development	10%	0	3
Economic Development	14%	0	1
Agency Management and Financial	11%	6	3

Total	100%	15	27
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* less than ½ percent

Profile of Operating Results

April 1, 1997, to September 30, 1997

Audit Activities	Totals
A. Reports Issued.....	15
B. Desk Reviews of CPA Audit Reports Issued.....	0
C. Audit Recommendations Issued.....	52
D. Dollar Value of Costs Questioned.....	\$2,049,683
E. Dollar Value of Recommendations that Funds Be Put to Better Use	\$9,092,825

Audit Followup Activities

F. Audit Recommendations Closed.....	37
G. Disallowed Costs Agreed to by Management.....	\$22,264
H. Dollar Value of Recommendations That Funds Be Put to Better Use Agreed to by Management.....	\$52,671
I. Unresolved Audit Recommendations.....	55
J. Dollar Value of Unresolved Audit Recommendations.....	\$12,754,479
K. Settlement Recoveries.....	\$6,100,000

Inspection Activities

A. Reports Issued.....	1
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Legislation/Regulation/SOP/Other Reviews

A. Legislation Reviewed.....	1
B. Regulations Reviewed.....	11
C. Standard Operating Procedures Reviewed.....	21
D. Other Issuances Reviewed*.....	92

* 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, 1997	Totals
A. Total Cases.....	330
B. Closed Cases.....	45
C. Pending Cases.....	26
D. Open Cases.....	259
E. Subjects Under Investigation.....	1,060
 Summary of Indictments and Convictions	
A. Indictments from OIG Cases.....	30
B. Convictions from OIG Cases.....	20
 Summary of Recoveries and Reductions of Risk	
A. Potential Recoveries and Fines as a Result of OIG Investigations.....	\$3,429,588
B. Reductions of Financial Risk as a Result of OIG Investigations.....	\$15,831
C. Reductions of Financial Risk as a Result of the Name Check Program.....	\$15,028,821
 Total:.....	 <u>\$18,474,240</u>
 SBA Personnel Actions Taken as a Result of Investigations	
A. Dismissals.....	0
B. Resignations/Retirements.....	1
C. Suspensions.....	0
D. Reprimands.....	0
 Program Actions Taken as a Result of Investigations	
A. Suspensions.....	0
B. Debarments.....	0
C. Removals from Program.....	0
D. Other Program Actions.....	0
 Summary of OIG Fraud Line Operation	
A. Total Fraud Line Calls/Letters.....	1,261
B. Total Calls/Letters Referred to Offices Outside the OIG.....	1,234
C. Total Calls/Letters Referred to Investigations Division for Evaluation.....	27

Investigations Activities - Referral Program	
A. Cases Referred to FBI.....	19
B. Referred to Other Agencies (Excluding FBI).....	0
C. Indictments from Referrals.....	1
D. Convictions from Referrals.....	1

E. Potential Recoveries and Fines as a Result of Referral Program.....	\$0
F. Reductions of Financial Risk as a Result of Referral Program.....	\$0

**Office of Inspector General
Actual Personnel on Board as of September 30, 1997**

A. Immediate Office.....	3
B. Auditing Division.....	32
Professional.....	28
Support.....	4
C. Investigations Division.....	46
Professional.....	37
Support.....	9
D. Inspection and Evaluation Division.....	8
Professional.....	7
Support.....	1
E. Management and Legal Counsel Division.....	9
Professional.....	7
Support.....	2
OIG Total.....	98

**Additional Temporary Disaster Staffing
Funded from Supplemental Appropriations**

A. Auditing Division.....	8
B. Investigations Division.....	5
C. Management and Legal Counsel Division.....	2
OIG Disaster Total.....	15

**FY 1997 Productivity Statistics
Second Six Months**

Office-Wide Dollar Accomplishments	Totals
A. Potential Investigative Recoveries and Fines.....	\$3,429,588

B. Management Avoidances as Result of Investigations.....	\$15,044,652
C. Disallowed Costs Agreed to by Management.....	\$22,264
D. Recommendations that Funds Be Put to Better Use Agreed to by Management.....	\$52,671
E. Settlement Recoveries.....	\$6,100,000
Total.....	<u>\$24,649,175</u>

Auditing Division Activities

A. Reports Issued.....	15
B. Disallowed Costs Agreed to by Management.....	\$22,264
C. Recommendation that Funds Be Put to Better Use Agreed to by Management.....	\$52,671
D. Settlement Recoveries.....	\$6,100,000

Inspection and Evaluation Division Activities

A. Reports Issued.....	1
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Investigations Division Activities

A. Cases Closed.....	45
B. Indictments.....	30
C. Convictions.....	20
D. Potential Investigative Recoveries and Fines.....	\$3,429,588
E. Management Avoidances.....	\$15,044,652
- Investigation Cases.....	\$15,831
- Name Check Program.....	\$15,028,821

FY 1997 Productivity Statistics

Full Year

Office-Wide Dollar Accomplishments

Totals

A. Potential Investigative Recoveries and Fines.....	\$24,681,064
B. Management Avoidances as Result of Investigations.....	\$31,590,118
C. Disallowed Costs Agreed to by Management.....	\$1,058,175
D. Recommendations that Funds Be Put to Better Use Agreed to by Management.....	\$5,370,719
E. Settlement Recoveries.....	\$6,100,000
Total.....	<u>\$68,800,076</u>
Auditing Division Activities	
A. Reports Issued.....	26
B. Disallowed Costs Agreed to by Management.....	\$1,058,175
C. Recommendation that Funds Be Put to Better Use Agreed to by Management.....	\$5,370,719
D. Settlement Recoveries.....	\$6,100,000
Inspection and Evaluation Division Activities	
A. Reports Issued.....	4
Investigations Division Activities	
A. Cases Closed.....	103
B. Indictments.....	52
C. Convictions.....	54
D. Potential Investigative Recoveries and Fines.....	\$24,681,064
E. Management Avoidances.....	\$31,590,118
- Investigation Cases.....	\$4,329,765
- Name Check Program.....	\$27,260,353

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	7 - 48
Section 5(a)(1)	Significant Problems, Abuses, and Deficiencies	7 - 48
Section 5(a)(2)	Recommendations With Respect to Significant Problems, Abuses, and Deficiencies	7 - 48
Section 5(a)(3)	Prior Significant Recommendations Not Yet Implemented	68
Section 5(a)(4)	Matters Referred to Prosecutive Authorities	7 - 48
Section 5(a)(5) and 6(b)(2)	Summary of Instances Where Information Was Refused	None
Section 5(a)(6)	Listing of Audit Reports	62
Section 5(a)(7)	Summary of Significant Audits	7 - 48
Section 5(a)(8)	Audit Reports Containing Questioned Costs	64
Section 5(a)(9)	Audit Reports Recommending that Funds Be Put to Better Use	65
Section 5(a)(10)	Summary of Reports Where No Management Decision Was Made	67
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, 1997, to September 30, 1997

TITLE	NUMBER	ISSUE DATE	QUESTIONED COSTS	FUNDS FOR BETTER USE
Business Loans				
Defaulted Loan Made by Eastside Bank & Trust	7-7-F-002-016	6/30/97		\$339,572
LowDoc Loan Program - Atlanta	7-7-F-006-017	7/7/97		\$67,500
LowDoc Loan Program at the Santa Ana DO	7-7-F-009-020	7/8/97		\$133,671
LowDoc Loan Program at WDO	7-7-F-007-021	7/18/97		\$23,677
LowDoc Loan Program - Dallas	7-7-F-008-022	7/31/97		\$152,500
West End Plaza Recreational Center, Hinesville, GA	7-7-F-019-024	9/25/97		\$12,000
Business Loan Guarantee Purchases	7-7-H-011-026	9/30/97	\$1,115,191	\$7,900,000
Disaster Loans				
CAIVRS	7-5-F-002-019	7/7/97		
Approval of Disaster Home Loans	7-6-F-003-023	9/4/97		
Surety Guarantees				
Fidelity & Deposit Co. of MD	7-7-H-006-025	9/30/97	\$934,492	
Agency Management and Financial				
FY 1996 Financial Statements - Management Letter to the CFO	7-6-H-006-012	4/11/97		

TITLE	NUMBER	ISSUE DATE	QUESTIONED COSTS	FUNDS FOR BETTER USE
FY 1996 Financial Statements - Management Letter to Atlanta Disaster OPC	7-6-H006-013	4/11/97		
Evaluation of Grant Proposal for WVHTCF	7-7-H-006-014	4/25/97		\$463,905
FY 1996 Financial Statements - Management Letter to the OCIO	7-6-H-006-015	4/29/97		
User Technology Associates, Inc.	7-7-S-918-018	6/6/97		

TOTALS (all programs)	Reports: 15		\$2,049,683	\$9,092,825
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APPENDIX II - Part A

Audit Reports with Questioned Costs April 1, 1997, to September 30, 1997

		REPORT S	RECs *	COSTS**	
				QUESTIONE D	UNSUPPORTE D
A.	For which no management decision had been made by March 31, 1997	4	4	\$1,361,906	\$0
B.	Which were issued during the period	2	3	\$2,049,683	\$781,461
	Subtotals (A + B)	6	7	\$3,411,589	\$781,461
C.	For which a management decision was made during the reporting period	1	1	\$22,264	\$0
	(i) Disallowed costs	1	1	\$22,264	
	(a) Due SBA			\$22,264	
	(b) Due program participant				
	(ii) Costs not disallowed				
D.	For which no management decision had been made by September 30, 1997	5	6	\$3,389,325	\$781,461

* Recommendations

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

APPENDIX II - Part B

Audit Reports with Recommendations that Funds Be Put to Better Use April 1, 1997, to September 30, 1997

		REPORTS	RECs [*]	RECOMMENDED FUNDS FOR BETTER USE
A.	For which no management decision had been made by March 31, 1997	1	1	\$325,000
B.	Which were issued during the period	8	13	\$9,092,825
	Subtotals (A + B)	9	14	\$9,417,825
C.	For which a management decision was made during the reporting period	2	2	\$52,671
	(I) Recommendations agreed to by SBA management	2	2	\$52,671
	(a) SBA level			
	(b) Program participant level			
	(ii) Recommendations not agreed to by SBA management			
D.	For which no management decision had been made by September 30, 1997	9 ^{**}	12	\$9,365,154

Recommendations.

^{**} The recommendations resolved did not address all the recommendations within the reports where they appeared; therefore, the number of reports without management decisions remains unchanged.

APPENDIX II - Part C

Audit Reports with Non-Monetary Recommendations April 1, 1997, to September 30, 1997

		REPORTS	RECOMMENDATIONS
A.	For which no management decision had been made by March 31, 1997	10	35
B.	Which were issued during the period	13	36
	Subtotals (A + B)	23	71
C.	For which a management decision was made (for at least one recommendation in the report) during the reporting period	10	34
D.	For which no management decision (for at least one recommendation in the report) had been made by September 30, 1997	16	37

APPENDIX II - Part D

Overdue Management Decisions September 30, 1997

Auditee	Report Number	Date Issue	Status
Business Loan Center	6-5-H-002-019	9/20/96	Under review by Office of Financial Assistance (OFA)
LowDoc Loan Program	6-5-E-002-022	9/30/96	Two of five recommendations under negotiation with OFA
Disaster Loans Assigned to LADO	7-5-F-005-004	12/23/96	One recommendation continues under review by program office
Maryland SBDC	7-6-H-001-006	2/6/97	One recommendation continues under negotiation with the District Office
Early Default of Guaranteed Loans	7-4-E-001-009	2/18/97	Recommendations continue under review by the Office of Financial Assistance
W.V. High Technology Consortium Foundation	7-7-H-001-007	2/10/97	Recommendation continues under review by the Assistant Administrator for Administration
Grant Closeout Procedures	7-7-H-001-011	3/31/97	Recommendation continue under review by the Assistant Administrator for Administration

APPENDIX II - Part E

Significant Audit Reports Described in Prior Semiannual Reports Without Final Action as of September 30, 1997

REPORT NUMBER	TITLE	DATE ISSUED	DATE OF MANAGEMENT DECISION ON RECOMMENDATION	FINAL ACTION TARGET FOR IMPLEMENTATION
3-2-S-401-014	Colson Service Corp.	12/03/92	09/24/96	06/30/96
3-2-C-002-033	Administration of 8(a) Program	03/31/93	09/30/94	09/30/95
4-3-H-006-021	8(a) Continuing Eligibility Reviews	09/30/94	12/30/94	04/30/95
4-3-H-011-016	SBA's Award of 8(a) Contracts to ASCI	05/16/94	12/30/94	06/30/95
5-3-H-004-006	SBA Loan Servicing and Debt Collection Activities	03/31/95	04/30/95	9/30/98
5-3-E-010-021	8(a) Competitive Mix	09/29/95	03/29/96	09/30/96
6-6-H-002-011	GeoDemographics, Ltd.	03/29/96	09/30/96	04/01/98
6-5-E-002-022	Low Documentation Loan Program	9/30/96	*	*
6-5-E-001-021	Basic Ordering Agreements	9/25/96	2/10/97	9/25/97
6-5-H-006-017	Section 8(a) Regular Dealers	8/21/96	9/30/96	8/20/97
6-6-H-003-023	Virginia SBDC	9/30/96	05/12/97	01/01/98
6-5-H-007-014	FY 1995 Financial Statements	5/1/96	10/28/96	9/30/97
7-6-H-005-003	EFT Disbursement Procedures	12/20/96	2/14/97	08/30/97
7-6-H-006-010	FY 1996 Financial Statements	2/28/97	5/7/97	10/31/97