



Office of Inspector General Small Business Administration

September 1997 Update

Business Loans

Office of Inspector General (OIG) Audit Uncovers Preferred Lender Loan Violated Agency Policy. An audit of Section 7(a) loan processing, currently underway, discovered that a Preferred Lender Program (PLP) loan, approved by the Atlanta District Office, would have **financed part of an equity injection for a Section 504 loan, contrary to Agency regulations.** The PLP loan had, however, not yet been disbursed and the district office acted to cancel the loan and restructure the Section 504 package. Neither the PLP processing documents nor the Section 504 loan package indicated this misuse of the funds. The lender indicated it was an oversight and cooperated with the SBA district office in correcting the error.

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' conflict of interest as both marketer and regulator. An audit released this month reviewed a random sample of 58 purchase decisions out of the Agency's 2,819 purchases totaling \$434 million in 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 stem from the district offices' conflicting roles in marketing SBA loans through the lenders, while concurrently providing oversight to those same lenders. The conflicting roles make district offices 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 would 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 generally agreed with the audit recommendations.

New York Software Company and its Chief Executive Sentenced for Money Laundering and RICO Violations. A Syracuse, New York, warfare-simulation software development company and its chief executive officer (CEO) were sentenced on September 12, 1997. 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 Racketeer Influenced and Corrupt Organization statute**, both in connection with a \$750,000 SBA-guaranteed loan. In return for the guilty pleas, the Government agreed to dismissal of the other charges 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 its attention.

Washington Company Owner Charged with Making False Statements. The president of a company which owned several Subway Sandwich stores in the Tacoma, Washington, area was charged in an information on August 22, 1997, 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.

Attorney for a New York Bank Sentenced to Prison for Conspiracy, Fraud, and Bribery. The former attorney for a now-defunct SBA participating lender bank headquartered in Watertown, New York, was sentenced on August 29, 1997, to 41 months imprisonment and \$100,000 restitution after being convicted of **conspiracy, bank fraud, and bank bribery**. The attorney had paid kickbacks to the bank's president to obtain loans improperly from the bank. The bank's president had also agreed to refer the bank's legal work to the attorney's law firm in return for one-sixth of the legal fees collected. This scheme generated almost \$2 million in fees for the law firm. In furtherance of the conspiracy, the president 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 most of these loans. As a consequence, the loans, several of which were guaranteed by SBA, were not properly secured and not repaid. Having lost \$13 million on bad loans, the bank was declared insolvent and was seized in 1993 by the Office of the Comptroller of the Currency (OCC). The OIG investigation was conducted jointly with the OCC, the Resolution Trust Corporation, and the FBI; it was based on a referral from SBA's Syracuse District Office.

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 on September 30, 1997, with one count of **bank fraud**. The OIG had been asked to join an investigation already under way by the FBI and the IRS, who had information 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 SBA-guaranteed loans for \$700,500 and \$105,000 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.

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. The convenience store business failed, and he defaulted on this loan after making only a few payments. In his loan application, the owner failed to disclose tax debts and a defaulted 1977 loan to a group of his health clinics from SBA's

Kansas City District Office. He also submitted Federal tax returns altered to overstate his income. This matter was referred to the OIG by a servicing loan officer in SBA's Kansas City District Office.

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Disaster Assistance

Audit of Disaster Home Loans Generates Positive Result. An OIG audit issued September 4, 1997, 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 employee training and experience and to policy imperatives on processing time (a goal of 7 to 21 days). 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 statistical sample of 150 loans out of 191,169 disaster home loans, totaling \$4.7 billion, that had been approved from October 1991 through September 1995. The error rate of 14 loans projected to an estimated 7,811 loans, totaling \$175 million, within the audit universe. Borrower cancellations reduced this estimate to \$114 million projected to have been disbursed for loans without required documentation, and an estimated \$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.

California Restaurant Owner Pleads Guilty to Making False Statement and Fraud. The former owner of a restaurant in Compton, California, pled guilty on April 14, 1997, to one count of **making a material false statement** to SBA and one count of **fraudulent use of a Social Security number (SSN)**. The man had applied for two disaster loans totaling \$240,579 for his business following the 1992 Los Angeles civil unrest. 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. Relying on this false information, SBA disbursed \$115,800 of his physical damage loan and \$18,200 of his economic injury loan. This investigation was opened as a result of information provided by SBA's Disaster Assistance Area 4 Office.

California Pharmacist Pleads Guilty to Making False Statement. The former owner of a pharmacy in Sherman Oaks, California, pled guilty on July 16, 1997, to one count of **making a false statement** to SBA. An investigation was initiated due to a referral from the Santa Ana Disaster Loan Servicing and Liquidation Center, which alleged that the subject submitted false financial information to SBA in relation to three disaster loans. He had received a \$100,000 disaster home loan following the 1993 severe winter storms and a \$45,000 disaster home loan and 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 his request contradicted information in the loan applications. The OIG investigation revealed that he had submitted to 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.

California Repair Shop Owner Sentenced for Making False Statements. The former owner of a TV and VCR repair shop in Los Angeles, California, was sentenced on September 22, 1997, 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 SBA/OIG initiated the investigation based on a referral from SBA's Los Angeles District Office and continued it jointly with the Social Security Administration's OIG and the U.S. Secret Service. The investigation revealed that the man had filed for bankruptcy under several SSNs

and concealed the bankruptcy filings from SBA to obtain two disaster loans totaling \$39,700 for his business following the 1992 civil unrest. Altered copies of income tax returns were submitted in support of his loan applications.

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

The owner of a Norwalk, California, jewelry shop pled guilty on September 29, 1997, 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 store owner was approved for SBA disaster loans totaling \$185,000 to rehabilitate the business. The OIG's investigation revealed that she had submitted a copy of a fictitious 1989 individual income tax return and an altered copy of her 1990 individual income tax return in support of her loan application. 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 opened a jewelry store. (SBA canceled the last \$25,300 of her available loan balance before it was disbursed to her.) The investigation was initiated based on referrals from SBA's Fresno district counsel and Disaster Assistance Area 4 Office.

Texas Auto Repair Shop Owner Sentenced for Making a False Statement.

The owner of a Fort Worth, Texas, auto repair shop was sentenced on September 19, 1997, 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 man claimed ownership of \$39,000 in stocks and bonds that he knew he did not have. The two business loans are in repayment default, but the home loan is current. This was a joint investigation conducted 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.

North Carolina Disaster Loan Recipient Sentenced for Making False Statements.

A Waynesville, North Carolina, woman was sentenced on August 27, 1997, 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 its disbursement of the initial \$10,000 of the loan, she submitted to the Agency a deed of separation from her husband which had been altered to significantly overstate her alimony income. As documentation of how she had spent the first \$10,000 (required before SBA would disburse the balance of \$28,400), she submitted falsified documentation including a purchase order for a mobile home, a certification of hazard insurance, a title insurance policy, and a mobile home certificate of title. Subsequently, she also submitted additional false documents, i.e., a purchase contract and two bank statements, to the investigating OIG special agent in support of her disaster-related claims. This investigation was initiated based on a referral from SBA's Disaster Assistance Area 2 Office.

Surety Bond Guarantees

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 with the type of contract and grossly underbid the project. The audit recommended that SBA cease payments on the two claims and recover \$866,942 already paid to the firm. The SBA's Associate Administrator for Surety Guarantees concurred in the audit recommendations.

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Agency Management and Financial

SBA Employee Sentenced for Misusing Loan Applicant's Social Security Number. A former miscellaneous documents clerk in SBA's Disaster Assistance Area 4 Office (DAO-4) was sentenced on June 6, 1997, 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 shared 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 stores lost a total of \$6,217 as a result of this fraudulent activity.

Editor's Notes:

Most of the articles appearing in this issue of the **Update** reflect outcomes of OIG investigative efforts. The **Update** generally reports all intermediate outcomes of criminal investigations (charges, pleas, court actions, convictions) as they occur, as well as final results (sentencings, settlements). While audits and inspections produce equally valuable results, they tend to take 6 to 9 months of research, analysis, and production prior to their publication. Consequently, they do not produce the same type of intermediate results that lend themselves to monthly reporting. Several audits and inspections are, however, currently underway and will be reported in upcoming issues of the OIG **Update**.



The following identifies the use of adjectives in these **Updates** to describe tax returns fraudulently submitted in support of loan applications:

Fictitious tax returns: The applicant submits "copies" of tax returns never filed with the IRS.

Altered tax returns: The applicant submits altered copies of tax returns actually submitted to the IRS.

Bogus tax returns: The applicant submits tax returns containing false information to both the IRS and SBA.



Most audit and inspection reports can be found on the Internet at:

WWW.SBAONLINE.SBA.GOV/IG/REPORTS.HTML

The Activity Update is produced by the SBA/OIG, James F. Hoobler, Inspector General.

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