



## Office of Inspector General Small Business Administration

November 1997 Update

Loans with deficiencies that should have precluded approval 10 % 11 %

Average number of deficiencies per loan with deficiencies 2.0 2.04

The sample was drawn from loans approved from inception of the program in December 1993 through September 1996. A deficiency was defined as an instance of non-compliance by lenders or district offices with either the Authorization and Loan Agreement or other SBA processing and disbursing procedures.

Deficiencies were found in 84 of the 120 sampled loans, with 171 deficiencies in all. For 13 loans, there were 14 deficiencies serious enough that the loans should not have been made under LowDoc procedures. These "fatal" deficiencies involved problems in repayment ability, character, credit worthiness, or eligibility. In addition, lenders had a conflict of interest on two loans. Other deficiencies related to IRS verifications, equity injections, verification of use of loan proceeds, and use of joint payee checks. All but 11 of the 157 "non-fatal" deficiencies involved non-compliance with general Section 7(a) program requirements as opposed to LowDoc-specific requirements.

Lenders said the primary reasons for deficiencies were loan officer error or lack of knowledge of requirements. The auditors noted that performance improved after the

### *Business Loans*

New LowDoc Audit Verifies Findings of Previous Audit. A second audit of the SBA's Low Documentation loan program (LowDoc) **produced results similar to an initial audit** conducted in September 1996. After the first audit of a nationwide sample of 70 loans was published, the former SBA Administrator requested that a larger sample be drawn to validate the results. Consequently, a second audit of 120 loans in Atlanta, Santa Ana, Washington, and Dallas was performed. The results were very similar:

	<u>First Audit</u>	
<u>Second Audit</u>		
Loans with processing deficiencies %	79 %	70

issuance of detailed program guidance in April 1996.

The report recommended that the Acting Associate Administrator for Financial Assistance (AA/FA) (1) review those cases where district offices disagreed with repair of guarantees on defective loans, and (2) develop a training program for new LowDoc lenders. Regarding the first recommendation, the Acting AA/FA stated that the Office of Financial Assistance (OFA) has long held that a guarantee called into question is not addressed in a conclusive manner until the loan is purchased. She further stated that OFA and OIG are currently identifying circumstances which may lead to denial or repair of the guarantee prior to purchase. The Acting AA/FA agreed with the second recommendation to provide training.

California Real Estate Agent Indicted for Bribery. A real estate sales representative in Glendale, California, was indicted on October 28, 1997, on one count of **bribery** of an SBA employee. The investigation was initiated based on a referral from SBA's Los Angeles District Office (LADO) on the same day that the woman allegedly offered compensation to a loan assistant in its Liquidation Division to become the listing agent for an SBA-foreclosed business property. The loan assistant notified his supervisor immediately after receiving the offer.

During subsequent telephone calls, and despite warnings that she and the loan assistant could get into

trouble, the realtor allegedly offered the loan assistant \$3,500 for the real estate listing. At a later face-to-face meeting, she gave the loan assistant \$1,000 as good faith money, and the real estate listing agreement was signed by her and the SBA employee. The following day, the realtor was given a letter from the LADO's Legal Division stating that the loan assistant did not have the delegated authority to execute the listing agreement. When given the letter, she denied ever personally meeting with the SBA loan assistant, making the employee any promises, or giving the employee any money. Other evidence contradicted those denials.

Texas Cellular Phone Distributor Pleads Guilty to Making False Statements. The owner and president of a Plano, Texas, cellular phone distributor pled guilty on November 20, 1997, to one count of **making false statements** to SBA.

In return, the Government agreed to dismissal of the other two counts on which he was previously indicted. The man obtained a \$230,000 SBA-guaranteed loan by submitting an SBA Form 912, Statement of Personal History, that bore a bogus Social Security number (SSN) and failed to disclose his criminal history.

The bogus SSN was used on his SBA Form 413, Personal Financial Statement, as well. He also admitted that he failed to disclose a number of debts in the loan application and provided SBA with altered tax returns and falsified invoices in support of the loan disbursements. The OIG opened this investigation based on a referral

from SBA's Dallas District Office and continued it jointly with the IRS.

Georgia Hotel Owner Sentenced to Prison for Making Material False Statements. The former owner of a hotel in Tybee Island, Georgia, was sentenced on November 5, 1997, to 4 months imprisonment, 3 years supervised release, \$213,150 restitution, a \$5,100 fine, and 200 hours community service. He had 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 payment of loan proceeds. The OIG initiated this investigation based on information received by the OIG Fraud Line.

Texas Automotive School Owners Indicted for Bank Fraud and Conspiracy. The owners of an automotive repair school in Houston, Texas, were indicted on November 14, 1997, on eight counts of **bank fraud, making a false statement to an FDIC-insured bank, and conspiracy.** Their company obtained a \$240,000 SBA-guaranteed loan in 1991. The OIG's investigation found that the couple submitted loan disbursement requests to the participating lender bank that falsely cited \$69,877 of construction work that was never completed. The indictment also charges that the husband fraudulently endorsed loan

disbursement checks totaling \$56,540. This investigation was initiated based on information developed during the OIG's Operation Clean Sweep research at SBA's Houston District Office.

Alabama Chemical Company Owner Indicted for Making False Statements and Misappropriating Collateral. The president and owner of a chemical company in Fort Payne, Alabama, was indicted on October 28, 1997, on one count each of **making false statements to a Federally-insured lender, making false statements, and misappropriation of SBA collateral.** The owner had obtained a \$750,000 SBA-guaranteed loan, purportedly to build a bleach processing factory. The OIG's joint investigation with the FBI discovered that the factory was never opened and loan proceeds were used, in part, for unauthorized personal expenses such as car and house payments. In addition, equipment purchased with loan proceeds that was to be used as collateral for this loan was sold by the man before he filed for bankruptcy, according to the indictment, and the proceeds from this sale were also used improperly. Further, the company owner allegedly failed to disclose that he had previously received a \$65,000 SBA-guaranteed loan for another chemical company in Chattanooga, Tennessee, which was already in default at the time of the Alabama company's loan application. The OIG's involvement in this investigation was based on a referral by SBA's Birmingham District Office.

\* \* \* \* \*

## *Disaster Assistance*

SBA Recovers Misused Loan Proceeds From Florida Businessman and His Two Companies. SBA recovered \$136,567 from a Homestead, Florida, businessman and two corporations of which he was president. The two businesses, a warehouse business and a "certified process server," had been approved for disaster loans totaling \$212,700, primarily to repair/replace real property, machinery, and equipment damaged by Hurricane Andrew. Based on information from SBA's Disaster Assistance Area 2 Office and the OIG's referral to the U.S. Attorney's Office for Southern Florida, a civil complaint had been filed against the businessman and the two corporations in 1996. The lawsuit alleged that proceeds of both loans had been diverted to unauthorized uses and that Borrower's Progress Certifications, SBA Form 1366, covering earlier disbursements totaling \$132,362 had been falsified so that SBA would continue disbursing loan funds. The man paid the Government \$26,653 on September 11, 1997, and on November 4, 1997, the Government was awarded a \$109,914 judgment on the **breach of contract** and **default of contract** charges. This matter was handled as part of the Justice Department's affirmative civil enforcement program.

California Lighting Company Owner

Indicted on Variety of Charges. The former owner of a lighting company in Los Angeles, California, was indicted on October 28, 1997, on three counts of **making false statements to SBA**, three counts of **using a false Social Security number (SSN)**, one count of **making a false statement to a Federally-insured financial institution**, and one count of **making a false statement on a bankruptcy petition**. The businessman was approved for a \$25,900 disaster business loan following the 1994 Northridge earthquake; however, no proceeds beyond the first \$10,000 were disbursed because SBA became aware of a foreclosure on a property which he owned (and where he resided) but had not disclosed on his application. He also applied for a disaster home loan following the 1995 floods in southern California, but this application was declined due to lack of repayment ability. The investigation, which the OIG initiated based on information provided by SBA's Disaster Assistance Area 4 Office, found that his business closed before the SBA funds were disbursed. It also showed that he used a false SSN and provided altered income tax returns in support of both applications. The company owner filed for bankruptcy to forestall eviction from the property that was in foreclosure, and the indictment charged that he used a second false SSN in the bankruptcy petition.

California Liquor Store Owner Sentenced for Making False

Statements. The owner of a Lomita, California, liquor store was sentenced on November 3, 1997, to 5 years probation, 1,000 hours community service, and \$87,000 restitution to SBA. The man previously pled guilty to one count of **making false statements in a loan application to a Federally-insured bank** and one count of **making a false statement to SBA.** In March 1991, the store owner submitted altered "copies" of 1987-90 income tax returns to a participating lender bank to obtain a \$631,500 SBA-guaranteed business loan. Similarly, he submitted altered copies of tax returns for 1989-91 to SBA to obtain disaster assistance for his business following the 1992 Los Angeles civil unrest. He ultimately obtained a \$71,800 physical damage loan and a \$59,200 economic injury loan. All of the altered tax returns significantly overstated his adjusted gross income and business income. This action resulted from a joint OIG/Secret Service investigation of falsified applications prepared by two southern California brothers acting as loan packagers; the case was opened as a result of a tip from a concerned citizen and a referral from SBA's Disaster Assistance Area 4 Office.

\* \* \* \* \*

## ***Small Business Investment Companies***

### **Officers of Michigan SSBIC Plead Guilty to Misapplying Funds of**

Financial Institution and Failing to File Required Currency Transaction Report. Two officers and directors of a specialized small business investment company (SSBIC) in Farmington Hills, Michigan, were charged in a misdemeanor criminal information on November 3, 1997. Each businessman was charged with one count of **misapplying funds of a financial institution** and one count of **failing to file a required Currency Transaction Report.** Both have pleaded guilty to the charges. With regard to the count of "misapplying funds", the two caused the SSBIC to loan money to a business in Michigan which they knew was going to be forwarded to a business in California previously denied a loan by the SSBIC. With regard to the count of "failure to file", the pair, as officers of the SSBIC and a related company, caused the related company to accept, in the regular course of business, \$20,000 in cash but failed to file a Currency Transaction Report with the Department of the Treasury. The investigation was conducted jointly by the U.S. Secret Service, the IRS, and the SBA/OIG; it developed from information uncovered in an investigation of another SSBIC.

\* \* \* \* \*

*Editor's Notes:*



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](http://WWW.SBAONLINE.SBA.GOV/IG/REPORTS.HTML)**

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

Comments or questions concerning this update or requests for copies of OIG audits, inspections, or other documents should be directed to Johnny Cahn, SBA/OIG, 409 Third Street, SW, Washington, DC, 20416-4110.

Telephone number: (202) 205-6580

FAX number: (202) 205-7382

If you are aware of suspected waste, fraud, or abuse in any SBA program, please call the OIG Fraud Line.

**OIG FRAUD LINE (202) 205-7151**  
in Washington, DC metropolitan area

**TOLL-FREE FRAUD LINE:**  
**(800) 767-0385**