



## Office of Inspector General Small Business Administration

February 1999 Update

### *Business Loans*

Audit Issued on Section 7(a) Loanmaking by Charlotte District Office Finds Non-Compliance in Some Instances. As part of a nationwide audit, the Auditing Division issued a report on the processing, disbursing and use of proceeds relating to 30 Section 7(a) loans assigned to the North Carolina District Office. The auditors determined whether 22 required SBA procedures, designed to reduce risks, were followed. The auditors found there was **non-compliance with at least 1 of the 22 procedures in 14 of the 30 loans**. Non-compliances included: approval of a \$71,000 loan to an ineligible applicant for an ineligible purpose, lack of Internal Revenue Service (IRS) tax verification (2 loans), lack of verification of use of proceeds (7 loans), lack of equity injection verification (2 loans), failure to obtain a Statement of Personal History (2 loans), missing settlement sheets (2 loans), and lack of compensation agreements detailing professional fees (2 loans). These non-compliances led to 3 loans with deficiencies: 1 loan was ineligible, 1 loan's proceeds were not spent as approved, and 1 loan needed to complete the IRS verification process. The auditors made recommendations to correct deficiencies (the ineligible loan was knowingly approved by SBA and therefore cannot be corrected) and to remind lenders and SBA

employees of proper procedures. The Acting District Director agreed.

President of Washington Rehabilitation Clinic Indicted for Bank Fraud and Making False Statements. The president of a rehabilitation clinic in Seattle, Washington, was indicted on February 4, 1999, on two counts of **bank fraud**, one count of **making material false statements** to SBA, one count of **making a false claim of citizenship**, and three counts of **making false statements to a Federally insured lender**. In 1994, the man had received an \$80,000 SBA-guaranteed loan to purchase chiropractic equipment for his clinic. The OIG's joint investigation with the Federal Bureau of Investigation (FBI) found that the man made false statements to obtain the loan and later converted loan proceeds to his personal use. In addition, the investigation found that, on his SBA loan application and on his applications to obtain three Federally guaranteed student loans, he falsely claimed that he was a U.S. citizen. Agents of the OIG, the FBI, and the Immigration and Naturalization Service (INS) arrested him in 1998 based on a warrant issued in 1984 by the U.S. District Court, District of Kansas. The outstanding arrest warrant did not appear during an earlier check of the man's criminal history, but was discovered in his INS file. The warrant was based on his 1984 indictment for

**making a false claim of citizenship; making false statements to obtain a Social Security card; fraud and misuse of visas, permits, and other documents; making false statements to the U.S. Department of Education; and misuse of a Social Security number.** (Updated from the October 1998 Update.)

California Tax Preparer Pleads Guilty to Conspiracy and Tax Evasion. A tax preparer in Pasadena, California, pled guilty on February 11, 1999, to one count of **conspiracy to defraud the Internal Revenue Service** and eight counts of **tax evasion**. The OIG had been asked to join a criminal investigation already under way by the IRS and the FBI, based upon information that the tax preparer may have been responsible for the preparation of altered tax returns submitted to financial institutions and to SBA on behalf of clients who had received SBA-guaranteed loans. The OIG reported the criminal prosecutions of two of these clients last year. The investigation confirmed that the "copies" of their Federal tax returns, submitted with their SBA loan applications totaling more than \$1,060,000, had been altered from those submitted to the IRS to substantially overstate their incomes. These discrepancies formed the basis for a search warrant that was executed on the tax preparer's business. The charges to which he just pled guilty were a direct result of the evidence gathered during the search. The investigation is continuing.

Investigation of California Loan Brokerage Firm Yields Further Results. New actions have resulted from an ongoing investigation of an Inglewood, California, loan brokerage firm.

**1** The principal owner of the loan brokerage firm was charged in an information on February 2, 1999, with four counts of **making false statements to a Federally insured financial institution** and with one count of **subscribing to a false statement on a tax return**. He pled

guilty to all five counts on February 8, 1999. In the plea agreement, the loan broker admitted his role in the submission of four SBA-guaranteed loan applications containing altered tax returns. The loans totaled \$2,460,000, and losses to SBA and a participating lender. He also admitted failing to report the firm's gross receipts, for 1991 and 1992, resulting in a total tax loss of approximately \$520,000. The brokerage firm specialized in financing the purchase of gas stations through the bank and may have brokered as many as 160 SBA-guaranteed loans having an aggregate value of some \$60 million. The OIG's examination of the loan files disclosed evidence of such fraudulent activities as false personal financial statements, false tax returns, and manipulation of documents to falsely show that the borrowers made substantial initial cash injections. The OIG's investigation of the loan brokerage firm's connection to the failure of the banking institution is being conducted jointly with the IRS and the FBI.

**2** The former owner of a gas station in Fontana, California, pled guilty on February 8, 1999, to three counts of **making false statements to a Federally insured lender**. In return, the Government agreed to dismiss the other three counts on which he had been indicted. The OIG's joint investigation with the FBI disclosed that man submitted a false Source of Cash Injection letter, a false personal financial statement, a false SBA settlement sheet, and altered individual income tax returns for 1987-1989, with his application for a \$1,000,000 SBA-guaranteed loan. He subsequently defaulted on the loan, leaving an unpaid balance of \$968,664. (Updated from the July 1998 Update.)

**3** A plumber doing business in Los Angeles, California, was sentenced on Feb-

ruary 8, 1999, to \$2,880 restitution to SBA and 3 years probation, with the first 8 months to be served in halfway house detention and home detention. He had pled guilty to one count of **making a false statement to a Federally insured lender**. The man submitted altered individual income tax returns for 1988-1990, as part of his application for a \$500,000 SBA-guaranteed loan. He subsequently defaulted on the loan, leaving an unpaid principal balance of \$440,595. (*Updated from the June 1998 Update.*)

**4** A man who formerly operated an Oriental rug business in Beverly Hills, California, was sentenced on December 7, 1998, to 4 months incarceration, 4 months home detention, 5 years supervised release, and \$677,000 restitution to SBA. He previously pled guilty to one count of **fraudulent receipt of money from a bank transaction**. The man falsely represented that the purpose of his \$1,000,000 SBA-guaranteed loan from a bank was to purchase rug inventory, when he actually intended to (and ultimately did) use the loan proceeds to pay debts associated with a real estate business he owned and to develop real estate. Neither expenditure was an eligible use of proceeds of an SBA-guaranteed loan. (*Updated from the June 1998 Update*)

California Saloon and Dance Hall Operator Indicted for Making False Statement. The former president of a saloon and dance hall in Durango, Colorado, was indicted on February 9, 1999, on one count of **making false statements to a Federally insured bank** and one count of **making false statements to SBA**. The charges, resulting from the OIG's joint investigation with the FBI, were regarding two SBA-guaranteed loans, totaling \$780,000, which his business received from the participating bank lender in 1996. The investigation determined that the man failed to disclose to

the bank or SBA that he owed his father and two realtors a total of about \$240,000 in connection with his purchase and sale of a prior business in southern California. He defaulted on the SBA-guaranteed loans after making only a few payments and he has since filed for both personal and corporate bankruptcy. This investigation was initiated based on a Suspicious Activity Report filed by the lender.

New York Businessmen Sentenced for Mail Fraud and Conspiracy. Three Long Island, New York, businessmen who had each pled guilty to one count of **mail fraud** and one count of **conspiracy** were sentenced in October 1998. Their sentences had been sealed and so were not reported until now. The business manager of an East Islip, New York, chiropractic and physical therapy center was sentenced to 5 months imprisonment. The chief financial officer of an affiliated therapy provider was sentenced to 3 months imprisonment and a \$5,000 fine. Lastly, the owner of the 2 concerns and another therapy provider was sentenced to 6 months imprisonment. Each defendant was also sentenced to 3 years supervised release. The OIG's investigation, conducted jointly with the FBI, disclosed that 2 of the men mailed reimbursement claims to insurance companies for physical therapy that was never provided to patients. The 2 men also forwarded fraudulent financial statements to a non-bank participating lender in January and May 1993 with the intent to obtain a \$750,000 SBA-guaranteed loan. Because the loan was never disbursed, neither SBA nor the lender incurred a loss. Between 1988 and mid-1994, the third man, a doctor, continually misrepresented that a licensed physical therapist or physician was rendering or overseeing his patients' physical therapy care. He caused false claims to be mailed to insurance carriers regarding those services and conspired in the submission of the false financial statements to

the lender. (*Updated from the January 1996 Update.*)

Mississippi Businessman Pleads Guilty to Bank Fraud. The owner of a trucking accessories business in Long Beach, Mississippi, pled guilty on November 24, 1998, to one count of **bank fraud**. In return, the Government agreed to dismiss one count of **misappropriation of SBA collateral** and the other three counts of **bank fraud** on which he had been indicted. The business obtained a \$100,000 LowDoc loan in 1996. The investigation found that the man removed, disposed of, and/or converted to his own use various items of business inventory that were pledged as collateral for the SBA-guaranteed loan. He filed for bankruptcy, leaving SBA with a potential loss of \$87,000. The investigation also determined that the man double-billed customers' credit cards, issued checks to several banks without sufficient funds to cover them, forged signatures to cash checks, and deposited closed account checks for a total bank fraud loss of \$49,077. The OIG joined this investigation at the request of the FBI. (*Updated from the July 1998 Update.*)

Former Deputy Sheriff in Minnesota Pleads Guilty to Wire and Bank Fraud. A former Chief Deputy Sheriff of Carver County, Minnesota, pled guilty in U.S. District Court in Colorado on February 19, 1999, to one count of **wire fraud** and one count of **bank fraud**. In return for his plea, the Government agreed to dismiss the other six felony counts on which he had previously been indicted. The man had personally guaranteed a \$100,000 SBA loan through a participating non-bank lender for a mail box franchise in Denver to be owned by his wife. A check disbursing \$80,000 of the loan proceeds was issued for the purchase of this franchise. The OIG's investigation revealed that the man forged an endorsement on the check and used the funds for his personal benefit. He also submitted a falsified Personal

Financial Statement on which he failed to disclose several debts and overstated his income. During the time period he was submitting the false loan documents, he had been arrested and was awaiting trial for misappropriating Drug Abuse Resistance Education funds in Carver County. He was ultimately convicted of these charges as well and is currently incarcerated in a Federal prison. (*Updated from the September 1998 Update.*)

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### *Disaster Assistance*

#### Investigation of North Dakota Private Business School Yields Further Results.

**1** The manager and prospective purchaser of the private business school was indicted on January 26, 1999, on 10 counts (**wire fraud, money laundering, making material false statements, and failure to refund unearned Federal student aid funds**) in addition to the three counts (**conspiracy and making false statements to SBA**) on which she had previously been indicted. The woman was managing, and in the process of purchasing, a private business school in Grand Forks, North Dakota, when the Red River flooded it in April 1997. She and four co-defendants were previously indicted for perpetrating a fraud scheme against SBA to obtain a \$122,900 disaster loan for the business school. The superseding indictment alleges that she also 1) faxed fraudulent Borrower's Progress Certification forms to SBA, 2) laundered SBA disaster loan funds through the bank account of another school she owned, 3) failed to make required student loan refunds of about \$543,765, and 4) made false statements to the U.S. Department of Education (ED). This school and the five other private business schools owned by her

closed on or about January 1998, and no payments were made on this disaster loan. The investigation was a joint effort by the SBA/OIG, the ED/OIG, and the IRS Criminal Investigations Division. (*Updated from the September 1998 Update.*)

2 The former comptroller of the private business school was sentenced on February 25, 1999, to 6 months home confinement, 3 years probation, and 100 hours community service. The account manager for a computer store in Fargo, North Dakota, was sentenced on February 26, 1999, to 50 hours community service, 2 years probation, and a \$1,000 fine. The comptroller of the school had pled guilty to **conspiracy** to defraud SBA, and the computer store official had pled guilty to **mail fraud**. A nine-count indictment had charged that the two men and three other defendants participated in a scheme to obtain the loan after the Red River flooded the school in 1997. According to the indictment, the scheme included false statements that the business school had purchased \$91,372 worth of computers following the flood. (*Updated from the December 1998 Update.*)

California Modeling and Talent Agency Owner Sentenced for Making False Statements. The owner of a modeling and talent agency in Los Angeles, California, was sentenced on February 8, 1999, to 5 years probation, 2,000 hours community service, and \$68,117 restitution to SBA. He had pled guilty to two counts of **making material false statements** to SBA. (*Updated from the October 1998 Update.*)

Owner of Florida Air Charter and Cargo Transport Company Sentenced for Conspiracy and Making Material False Statements. The owner of a Miami, Florida, air charter and air cargo transport company, was sentenced on

January 25, 1999, to 6 months home confinement with electronic monitoring, 3 years probation, 250 hours community service, and a \$150 assessment. He previously pled guilty to 1 count of **conspiracy** and 2 counts of **making material false statements** to influence SBA to disburse a \$288,500 disaster loan. The amount of the loan was based on representations to SBA as to what it would cost the company to replace an airplane destroyed by Hurricane Andrew. (*Updated from the October 1998 Update.*)

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

Former Rhode Island Banker Pleads No Contest to Filing False Document. On March 1, 1999, a former bank official pled no contest in Rhode Island Superior Court to one count of **filing a false document** and agreed to voluntarily contribute \$10,000 to the Rhode Island Violent Crimes Indemnity Fund. He had been vice president and part owner of a Rhode Island bank and the principal of a Newport Rhode Island shipyard. Both businesses are now defunct. He was indicted in 1994 on charges that he engaged in a **racketeering** enterprise and **obtained money under false pretenses**. The OIG's joint investigation with the Rhode Island State Police disclosed that the man had borrowed a total of \$300,000 from two small business investment companies under the pretense that the loan proceeds were to be used by the shipyard. In fact, they were diverted to the bank and investment bank. The FBI referred this matter to the OIG. The matter was originally presented to the U.S. Attorney's Office; however, they deferred prosecution to the State. (*Updated from the May 1994 Update.*)

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## ***Agency Management and Financial Activities***

Former SBA Job Applicant Debarred from Any Federal Employment Due to False Statement. A man who in the summer of 1997 had applied for employment with SBA's Office of Financial Operations, Denver, Colorado, was debarred on February 4, 1999, from competing in an examination for, or accepting appointment to, any position with the Government. In addition, the decision issued by the Office of Personnel Management (OPM) based on evidence provided by the OIG canceled any Federal job applications he previously submitted. The debarment will remain in effect for 4 years from the date on which OPM's review of the matter began. The man previously pled guilty to one misdemeanor count of **making a fraudulent demand** for wages by making false statements in the application he submitted to SBA. The OIG's investigation determined that, in applying for a Financial Specialist position, the man had failed to disclose five occasions on which he had been arrested and/or imprisoned. In addition, he falsely stated that he had received two Bachelor of Science degrees and a Master's degree and that he was a Certified Public Accountant. He also represented that he had not been fired from a job, when in fact he had been fired by another Government agency for submitting a falsified job application. The OIG initiated the investigation based on a referral from SBA's Office of Human Resources. In the fall of 1997, after the OIG's initial inquiries confirmed that certain statements in his application were false, SBA withdrew the job offer previously made. *(Updated from the August 1998 Update.)*

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## ***Minority Enterprise Development***

Former Owners of Section 8(a) Firm Settle Civil Fraud Case. The former owners of a Section 8(a) company denied liability but agreed on February 23, 1999, to pay the Government \$375,000 to settle findings that they violated the False Claims Act. The firm had applied to participate in the Section 8(a) program in September 1993 and was approved in June 1994. Allegations were subsequently received that one of the owners had lied about his personal financial condition. An SBA/OIG audit revealed that one of the owners exceeded the Section 8(a) personal net worth limit. The OIG's investigation confirmed that the owner had submitted false statements to SBA and **misrepresented his personal financial condition** when he reported investment property as his personal residence. To have accurately reported the property would have disqualified him as a Section 8(a) participant. In February 1998, the matter was presented to the Civil Division of the U.S. Attorney's Office with jurisdiction over the matter. On December 18, 1998, the AUSA sent the owner's attorneys a demand letter and a draft complaint for relief for the alleged violations. The \$610,000 sought therein was triple the amount of profits earned on the firm's Section 8(a) contracts, plus a \$10,000 penalty. In March 1998, the owners sold the firm and voluntarily withdrew from the Section 8(a) program.

### *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***

Other IG related material can be found at:

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