Office of Inspector General
Small Business Administration

August 1999 Update

Business Loans

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

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

Iowa Restaurateur Pleads Guilty to Making Material False Statements. The former president of a restaurant and dairy freeze in Lineville, Iowa, pled guilty on June 30, 1999, to one count of **making material false statements** to SBA regarding his use of funds from a $50,000 direct SBA loan he received in 1994. He qualified for this loan as a Vietnam-era veteran. OIG's investigation found that he made numerous false statements to SBA regarding his use of the loan proceeds, which were intended to pay for equipment, remodeling expenses, and the remainder of the purchase price of his restaurant. After making only a few payments, the former owner defaulted on this loan, closed the restaurant, and left Iowa. SBA recovered only $2,280 in the resulting liquidation. This investigation was initiated based on a referral from SBA's Des Moines District Office. *(Updated from the April 1999 Update.)*

Investigation of California Loan Brokerage Firm Yields Further Results. The continuing investigation of an Inglewood, California, loan brokerage firm has recently produced more results.

1 Married owners of a gas station in West Covina, California, were sentenced on July 22, 1999. The husband was sentenced to serve 15 months in prison, and 5 years of supervised release; his wife was sentenced to serve 1 month in prison, 5 months of home detention, and 5 years of supervised release. In addition, they were ordered jointly to pay $25,000 in restitution to SBA. They previously pled guilty to four counts of **making false statements to a federally insured financial institution**. The couple had submitted altered Federal income tax returns for 1988 and 1989 with their application for $1 million SBA-guaranteed loan to the participating bank. They subsequently defaulted on the loan and, after all liquidation efforts had been completed, SBA charged off a loss of approximately $500,000. *(Updated from the January 1999 Update.)*

2 The former owner of a gas station in Fontana, California, was sentenced on August 16, 1999, to serve 2 months in prison, 4 months of home detention, and 5 years of supervised release. He was also ordered to pay $1,044,514 restitution (75 percent to SBA) and a $150 fee. He previously pled guilty to three counts of **making false statements to a federally insured lender**. He had submitted a false personal financial statement, a false SBA settlement sheet, and altered individual income tax returns for 1987 through 1989, with his application for a $1 million SBA-guaranteed loan. The owner subsequently defaulted on the loan, leaving an unpaid balance of $968,664. *(Updated from the February 1999 Update.)*

Virginia Insurance Agent Pleads Guilty to Mail Fraud. A Vienna, Virginia, field agent for a life insurance company was charged with and pled guilty to one count of **mail fraud** on June 17, 1999. A joint investigation by SBA/OIG, Postal Inspection Service, and the FBI showed that, from 1992 through 1998, the agent fraudulently misappropriated approximately $261,758 from the insurance company and its policyholders. SBA/OIG initiated its investigation following a May 1998 referral from SBA's Washington District Office. The insurance company had forwarded a copy of a letter authorizing them to release a collateral lien SBA held on an insurance policy that belonged to one of the agent's clients, a former SBA loan applicant. The letter was purportedly from SBA's Washington District Director, but he had retired more than 1 year before the date on the letter. The investigation proved that the bogus letter was actually prepared and sent by the agent, as part of his scheme to defraud the insurance company and the policyholder.

Virginia Taxicab Company Owner Indicted for Making False Statement to SBA. The president and owner of a taxicab company in Culpeper, Virginia, was indicted on August 9, 1999, on one count of **making a false statement to SBA** to obtain a $35,000 Low-Doc loan for her business. She had represented on SBA Form 4-L, Application for Business Loan, that she had no previous criminal history. OIG's investigation established, however, that prior to the date of her loan application she had been arrested in five separate incidents.

Missouri Businessman Indicted for Mail Fraud, and Making False Statements. A Missouri businessman was indicted on July 22, 1999, on two counts of **mail fraud**, two counts of **using a false Social Security number**, one count of **making material false statements** and one count of **impersonating a U.S. Government officer**, in connection with alleged schemes to defraud SBA, a small business lending company, and an insurance company. One count each of mail fraud and making material false statements relate to a $295,000 SBA-guaranteed loan he applied for in March 1999. His corporation was supposed to use SBA loan proceeds to purchase an existing day care center in St. Louis. The investigation found that the businessman submitted false statements regarding his educational background, work experience, criminal history, and financial status, for the purpose of obtaining the SBA-guaranteed loan. The joint SBA/OIG, Department of Health and Human Services (HHS) OIG, Social Security Administration OIG, and Postal Inspection Service investigation was initiated based on a referral from HHS/OIG. Following the man's indictment, a warrant for his arrest was issued, and he surrendered to Federal authorities on July 29, 1999.

Disaster Assistance

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

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

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

California Owner of Italian Marble Business Arrested in Connection with Mail Fraud. The former owner of an Italian marble business in North Hills, California, was arrested on August 4, 1999, based on his May 1999 indictment for defrauding SBA. The Immigration and Naturalization Service arrested the former owner in New York City as he entered the country following a flight from Italy and subsequently turned him over to the custody of SBA/OIG special agents. He was previously indicted on three counts of **mail fraud**. He had obtained a $417,000 physical-damage disaster loan for his business following the 1994 Northridge earthquake. OIG initiated this investigation based on a call to the Fraud Line and additional information provided by SBA's Disaster Assistance Area 4 Office. The investigation revealed that he submitted a false corporate tax return and an altered personal tax return to secure the disaster loan from SBA. According to his accountant, the owner transferred most of the funds from the SBA disaster loan to his bank account in Italy. The loan has been placed in liquidation status. *(Updated from the May 1999 Update.)*

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Surety Bond Guarantees

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

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

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

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8(a) Business Development

New York Contractor Charged with Conspiracy, Making Material False Statements, and Bank Fraud. The president of a construction company in Long Island City, New York, was charged in a three count criminal information filed on August 12, 1999, with **conspiracy**, **making material false statements** to SBA, and **bank fraud**. The information charges that, as part of his company's 1995 application to obtain certification into SBA's 8(a) program, he falsely stated on an SBA Form 912, Statement of Personal History, that he had never been arrested or charged with a crime. The investigation disclosed that local authorities in Maryland had arrested him on theft charges in 1986. He is also charged with submitting documents containing inflated income information to induce a federally insured financial institution to extend a $50,000 line of credit to his company. In 1997, the company was awarded a $378,000 8(a) contract to do work at the Federal Correctional Institution in Otisville, New York. The information, additionally, charges that he and one or more others conspired to defraud the United States by submitting fraudulent payment and performance bonds and falsified payroll reports in connection with the 8(a) contract. OIG's joint investigation with FBI was initiated based on a referral from the Federal Bureau of Prisons. *(Updated from the April, 1999 Update.)*

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Entrepreneurial Development

Audit of Women's Business Development Center Finds Certain Unallowable Claimed Costs. An audit of an SBA cooperative agreement awarded to a business development center located in Dallas, Texas, found $15,000 of **unallowable claimed costs or unexpended funds**. In addition, some required training sessions were not conducted. The audit report recommended that the center reimburse SBA $15,000 for the unallowable and unexpended Federal funds. The Assistant Administrator for Administration concurred with the recommendation.

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Agency Management and Financial Activities

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

SBA Employee in Denver, Colorado, Indicted for Embezzlement and Misusing False Social

Security Number. A former voucher examiner in SBA's Office of Chief Financial Officer (OCFO), Denver, Colorado, was indicted on July 28, 1999, on 13 felony counts of **embezzlement** and 1 count of **misusing a Social Security number**. OIG's investigation determined that she fraudulently obtained more than $21,000 in SBA funds by means of false electronic travel vouchers and false electronic vendor invoices. Her scheme involved entering false information via her work computer to have Government funds electronically deposited into her personal bank account. After being contacted by OIG, she resigned her position at SBA. An internal review by OCFO of their procedures after OIG's investigation revealed that substantially more funds were embezzled than OCFO was initially aware of. This investigation was initiated based on a referral from OCFO's Denver Finance Center.

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:

WWW.IGNET.GOV

The Activity Update is produced by the SBA/OIG, Phyllis K. Fong, Inspector General.

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