



Office of Inspector General U.S. Small Business Administration

July 2004 Update

Agency Management

OIG Issues Report on Compliance with the Federal Managers' Financial Integrity Act (FMFIA) Reporting Requirements. On July 29, 2004, OIG issued an audit report on SBA's Process for Complying with the FMFIA Reporting Requirements in Fiscal Years 2002 and 2003. The audit disclosed that SBA did not establish and maintain an effective process for ensuring SBA's compliance with FMFIA's annual internal control assessment and reporting requirements. The audit disclosed the following findings: 1) SBA did not effectively communicate its FMFIA assessing and reporting requirements; 2) SBA's policies and procedures regarding internal control assessments were not sufficient; 3) Management did not perform complete risk assessments of their respective offices in accordance with regulations; 4) Office of the Chief Financial Officer (OCFO) needed to take a more active role in monitoring the FMFIA reporting process; and 5) SBA's FY 2002 Performance and Accountability Report regarding the Agency's internal control process contained inaccurate information. The report concluded that SBA had a potential material weakness related to its FMFIA internal control assessment and reporting process. OIG made 11 recommendations to correct the identified FMFIA reporting compliance deficiencies.

Agency Completes Two Final Actions on Georgia District Office Sponsorship Events Audit. The following two final actions were completed: 1) the Georgia District Director issued a memo to district office employees providing guidance on solicitation and acceptance of gifts, and 2) the Agency issued the procedural notice "SBA Field Offices' New Procedures – Business Assistance Trust (BAT) Fund." The notice contained procedures for depositing cash gifts into the BAT fund, expending the money, and tracking expenditures.

Agency Completes Five Final Actions on Cosponsorship Activities – Los Angeles District Office (LADO) Audit. As a result of the audit, the Office of Field Operations

provided LADO with written instructions concerning cosponsorship activities. These instructions satisfied the following five audit recommendations: 1) only solicit and accept gift funds from allowable sources that legal counsel has determined not to have an apparent conflict of interest with the Agency; 2) deposit all SBA gift funds in the BAT fund or disburse per the donor's request; 3) deposit excess registration fees with the United States Treasury, retain them for the next cosponsored event, or return fees to the participants on a pro-rata basis; 4) appropriately budget cosponsored events and accurately report the sources and use of all funds; and 5) follow Federal law and SBA guidelines in executing, conducting, and reporting cosponsored events, and soliciting and accepting gifts to the Agency.

Agency Completes Four Final Actions on Audit of SBA's FY 2003 Financial Statements – Management Letter. The Agency has completed the following four final actions: 1) SBA has taken steps to require that all transactions processed in Oracle pass procurement funds control edit checks; 2) CFO documented their procedures and assumptions when calculating the Surety Bond Guaranty estimated liability and related expense; 3) OCFO has agreed to work with OMB to determine the proper treatment for the Modification Adjustment Transfer (MAT) adjustment considering the SBA's asset sale program and results; and 4) a procedural notice was issued providing a process that requires adequate obligations for loan file shipping costs.

Agency Completes Final Action on SBA's Information System Controls for FY 2003 Financial Statement Audit. A final action was completed when the CFO agreed to ensure that all change control forms are complete and have appropriate signatures before changes are implemented in production.

Agency Completes Five Final Actions on Audit of SBA's FY 2003 Financial Statements. The following five final actions have been completed: 1) OCFO will initiate work with the Office of Disaster Assistance (ODA) and the Office of the Chief Information Officer (OCIO) to develop

routines to periodically validate outstanding disaster loan undelivered orders and de-obligate them as appropriate, and the OCFO will recommend that the ODA implement such routines into their new DCMS system; 2) OCFO will explore ways to automate a comparison of offline journal vouchers (JVs) processed against the daily funds availability report in order to prevent exceeding apportioned authority or realized resources as an additional funds control measure, and will improve its manual funds control and documentation over manual JVs; 3) OCFO corrected all budgetary proforma errors and continues to review proformas, implement new proformas, and modify existing proformas as needs change and requirements dictate; 4) OCFO will encourage the Office of Procurement and Grants Management to deobligate administrative transactions in a timely manner; and 5) OCFO will work with OCIO to explore the possibility of a semi-automated routine to compare daily funds availability with daily disbursements schedules.

Business Loan Programs

OIG Issues Audit Report on an Early Defaulted Loan.

On July 9, 2004, the OIG issued a final audit report on an early defaulted loan. The OIG found that the lender did not comply with SBA rules and regulations in the approval of the guaranteed loan. The lender did not follow prudent lending practices in evidencing repayment ability, resolving questionable credit issues, and disbursing loan proceeds. As a result, SBA made an improper payment of \$142,549 when it erroneously honored the guaranty. The audit report included a recommendation to recover the full amount of the guaranty paid to the lender. The Associate Administrator for Portfolio Management (AA/PM) partially agreed with the finding, but did not believe the lender was deficient for failing to consider the impact of a pending working capital loan when considering the borrower's repayment ability. The AA/PM also did not agree that failure to pay Federal income taxes necessarily constituted evidence of poor character. The AA/PM stated that the lender had been asked to respond to the audit report.

OIG Issues Final Report on a \$1 million Defaulted Loan.

On July 12, 2004, the OIG issued a final audit report on a \$1 million SBA defaulted loan. The loan was judgmentally selected for review as part of the OIG's ongoing program to audit SBA guaranteed loans charged-off or transferred to liquidation within 24 months of origination (early default). The lender did not follow SBA guidance and prudent lending practices when it approved and closed the loan. Specifically, the lender

did not: 1) validate the source of the borrower's equity injection; 2) use proper appraisal methods; 3) adequately examine borrower credit reports; or 4) verify the borrower's management qualifications. While the SBA agreed to a 50 percent repair of \$373,760, the SBA should have either obtained a 100 percent repair or processed a full denial of the guaranty because of the factors discussed above. The SBA management agreed to require the lender to repay \$111,240, and is requesting that the Office of General Counsel determine if the lender should be required to repay the remaining guaranty amount.

Two Texas Convenience Store Owners Plead Guilty. On July 12, 2004, a convenience store owner in Arlington, Texas, pled guilty to **an information**. The owner pled guilty to tampering with a government record by making a false statement on a sworn renewal application for a Texas Alcoholic Beverage Commission permit claiming to be a U.S. citizen when she was not. The store owner received 360 days incarceration and a \$2,000 fine. On July 27, 2004, a second convenience store owner also pled guilty to tampering with a government record by making a **false statement** on a sworn renewal application for a Texas Alcoholic Beverage Commission permit claiming to be a U.S. citizen when he was not. The OIG conducted these investigations with the Department of Homeland Security (DHS), Social Security Administration (SSA), Department of Agriculture, Texas Department of Public Safety, and the Texas Alcoholic Beverage Commission (TABC).

OIG Issues Two Reports on Guaranteed Loans. On July 29, 2004, the SBA OIG issued an audit of an SBA guaranteed loan. The audit disclosed that the lender did not exercise prudent lending practices in determining that the borrower had repayment ability, and the lender did not provide a justification for projected earnings that were 52 percent higher than the norm for franchises operating in tourist areas. As a result of the lender's lack of due diligence, SBA made an improper payment of \$542,663 when it honored the guaranty. The SBA management generally agreed with the report but delayed implementing the recommendation until the lender had been given an opportunity to explain the variance in repayment ability. Since there was no information in the lender's loan file to justify revenues used in the repayment calculation, the OIG recommends full recovery of the amount paid to purchase the guaranty. On July 30, 2004, a second report was issued. This audit disclosed that the lender did not have adequate documentation to support 96 percent of the leasehold improvements reimbursed with loan proceeds. The lender also permitted the eligible passive company to charge rent well above the limit allowed under SBA regulations. As a result of these violations, SBA is entitled

to recover \$362,207 that was paid to the lender to purchase the guaranty on the loan from the secondary market. The OIG recommended that the Associate Administrator for Financial Assistance recover the full amount paid to the lender to purchase the guaranty. The SBA management agreed that the lender did not adequately address the issues at the time the loan was originated or when SBA purchased the guaranty. However, the SBA has delayed implementation of the recommendation until the lender has an opportunity to address the inconsistencies. Based on the documentation in the lender's loan file, the OIG does not believe that the lender has documentation to support the use of loan proceeds, and therefore, recommends full recovery of the guaranty.

Former Ohio General Manager Charged with An Information. On July 2, 2004, the former general manager of a food manufacturing business formerly located in Portsmouth, Ohio, was charged in **an information**, on one count of submitting a false statement to the SBA. The general manager was charged for his involvement in a scheme to defraud the SBA and a participating lender in connection with a \$700,000 loan made to the business in April, 1995. The purpose of the loan was to obtain working capital and to purchase land, new construction, machinery, and equipment. Both the general manager and his spouse (the president of the company) provided personal guaranties to obtain the loan. The OIG investigation revealed that they formed two shell corporations for the purposes of concealing the purchase of substandard machinery and equipment by their company and the theft of loan proceeds. After the loan closing, the food manufacturing company and the two shell corporations each submitted correspondence and bogus invoices to the SBA and the bank detailing fabricated sales agreements with the corporations, including grossly inflated purchase amounts. The false documents also listed fictitious addresses and telephone numbers, which actually belonged to friends and acquaintances of the president and general manager. The proceeds from these fraudulent sales were then laundered through bank accounts held in the names of the shell corporations and converted to personal use. The investigation also revealed that the company actually obtained or purchased most of the substandard machinery and equipment from two undisclosed companies before the loan was approved. These purchases were made at costs much less than the prices later reported on the bogus invoices. The investigation was based on a referral from the SBA Columbus District Office.

Houston Man Sentenced for Making False Statements. On July 12, 2004, a Houston, Texas, man was sentenced to 2 years probation, fined \$1,000 and ordered to serve 60 hours of community service in connection with his conviction on one count of making a **false statement** to the SBA. The **false statement** was made in connection with an attempt to obtain a \$2.7 million loan to buy a local hotel. The Texas man pled guilty to a **superseding information** that was filed on February 6, 2004. He admitted to falsely representing, in a personal financial statement, that he had cash assets of \$200,000. This false statement was made in an attempt to influence the action of the SBA in connection with a loan application for \$2.7 million to purchase a local motel. The actual price of the property was \$2 million. The Texas man and his co-defendants were arrested by agents after signing SBA loan documents containing the false statement at a closing held at a local title company. The SBA OIG conducted this investigation jointly with the Federal Bureau of Investigation (FBI).

Twelve Texas Loan Recipients Indicted. Twelve SBA loan recipients were indicted by the U.S. Attorney's Office, Southern District of Texas, for **false claim of U.S. citizenship**, on SBA Form 912, Statement of Personal History, in order to obtain an SBA loan. The SBA OIG agents and other task force members arrested eight of the subjects, four remained at large. The OIG is conducting this continuing investigation jointly with the DHS, Harris County Organized Crime Task Force, SSA, and TABC.

Agency Completes Final Action on Microloan Program: Moving Toward Performance Management. The Office of Financial Assistance satisfied an OIG recommendation when it issued SBA Procedural Notice "Reporting Requirements for the Microloan Program." The notice was published to ensure that program staff consistently enforces all reporting requirements.

Disaster Loan Program

New York Man Sentenced After Guilty Plea. A New York man was sentenced on July 19, 2004, to 3 years probation, including a 6 month term of home confinement. He was also ordered to pay restitution in the amount of \$34,356 (\$31,208 to the SBA, \$1,282 to a New York bank, and \$1,865 to a California bank). The sentencing was a result of his guilty plea on February 19, 2002, to one count of **wire fraud and two counts of bank fraud**. The charges related to a scheme perpetrated by the New York man and a doctor to defraud the SBA of disaster loan funds. The man had been assisting a plastic surgeon with the care of the doctor's elderly mother during 1999 and

2000. In late 1999, the doctor's mother's home in Cortland Manor, NY, was allegedly damaged by Hurricane Floyd. The doctor applied for and received a disaster loan from the SBA in the name of her mother in the amount of \$78,300. The man managed much of the daily dealings with the SBA while the doctor was in California attending to her medical practice. With the knowledge and consent of the doctor, the man submitted false statements to the SBA by forwarding altered invoices for work purportedly performed on the home of the doctor's mother. Some of the altered invoices were for work performed on his personal properties. The allegations were originally referred to the SBA OIG by the doctor in an attempt to blame the man entirely, and to get out from under the SBA loan. The man cooperated with the investigation and revealed the doctor's involvement in the fraud. The SBA OIG conducted this investigation jointly with the FBI.

Government Contracting and Business Development Programs

OIG Issues Report on Expenses for Meals and Refreshments Incurred by the Latino Coalition Foundation. On July 19, 2004, SBA OIG issued a final report on the expenses for meals and refreshments incurred by the Latino Coalition Foundation on SBA 7(j) Cooperative Agreement SBAHQ-02-J-0021. The audit disclosed that \$1,001.80 in unallowable costs was spent on alcoholic beverage service at a welcome reception. Improvements are needed when awarding and administering 7(j) cooperative agreements as SBA did not always adequately determine whether expenses were allowable and reasonable. For example, it could be argued that it was not reasonable for SBA to reimburse the Coalition approximately \$100 per person for a dinner based on a billing estimate anticipating 150 guests. The OIG made two recommendations to the Assistant Administrator for Administration to correct the deficiencies identified in the report, including recovery of the unallowable costs. The Assistant Administrator agreed with both recommendations.

This monthly update is produced by the SBA OIG, Harold Damelin, Inspector General.

The OIG has established an e-mail address (oig@sba.gov) that we encourage the public to use to communicate with our office. We welcome your comments concerning this update or other OIG publications. To obtain copies of such documents please contact:

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