



Office of Inspector General Small Business Administration

September/October 2001 Update

Business Loan Programs

OIG Issues Audit Report on Preferred Lender Oversight Process. On September 27, 2001, OIG issued an **audit report on the Preferred Lender Program (PLP) Oversight Process.** The audit, part of OIG's plan to evaluate SBA's lender oversight effort, was conducted to determine if SBA's oversight of the PLP ensures that lenders were properly selected for participation in the program. The audit identified lenders not processing, servicing, and liquidating loans in accordance with SBA policies and procedures.

OIG determined that program oversight needed improvement to ensure lenders were properly selected for participation and to identify those not in compliance with SBA guidelines. Specifically, the audit disclosed the following.

- Not all lenders were selected for review, and their past due, delinquent, and liquidation status loans were not always evaluated.
- Annual reviews did not assess financial and lender based risk factors.
- Lender evaluation worksheets allowed lenders who did not meet performance benchmarks to obtain passing scores and district offices to impact scores.
- Annual reviews were not coordinated with the PLP renewal process.
- There was no documentation that non-bank lender safety and soundness examination results were considered during the renewal process.

The Associate Administrator for Lender Oversight and the Associate Administrator for Financial Assistance agreed with the recommendations concerning selecting lenders for review, scoring annual reviews,

coordinating annual PLP reviews and lender renewal dates, and documenting safety and soundness examination results in the annual renewal process. They partially agreed with the recommendations concerning emphasizing performance benchmarks in the annual review scoring process and informing district offices of safety and soundness examination results for non-bank lenders. They disagreed with recommendations concerning selecting loans for review and scoring lender evaluation worksheets.

OIG Issues Audit Report on Loan Processing and Servicing. On October 29, 2001, OIG issued the final report covering the **audit of an SBA lender.** The audit was initiated based on a referral from the Office of the Comptroller of the Currency (OCC) and the objective was to determine whether the bank was processing and servicing loans in accordance with SBA policies and procedures. OIG reviewed 12 loans processed and serviced by the bank to determine the level of compliance with SBA policies and procedures.

OIG determined that the bank had not been processing and servicing loans in compliance with SBA's policies and procedures as reported by OCC, and that corrective actions recommended by OCC had been implemented and were effective. However, we noted that additional improvements were needed in the areas of: (1) equity injections; (2) use of loan proceeds documentation; (3) compensation of packager and loan service providers; and (4) documentation of compensation paid to outside agents. The South Florida District Office agreed with our recommendations and notified the bank to implement corrective action.

Ohio Residents' Indictments Adjudicated. The January 2001 indictments of four residents of the Cleveland, Ohio, area have been adjudicated. On

August 10, 2001, a jury found a real estate agent/business broker guilty of both counts (**making false statements to SBA** and **conspiracy to defraud the Government**) on which she had been indicted. On the same day, the SBA borrower was sentenced to 4 months home confinement, 3 years probation, and \$46,500 restitution to SBA; he previously pled guilty to one count of **making a material false statement**. On August 22, 2001, a seller of a business to the borrower was sentenced to 4 months home confinement, 1 year probation, and \$107,250 restitution to SBA; he previously pled guilty to one count of **making false statements to SBA**. On September 6, 2001, the one count of **making false statements to SBA** on which another seller had been indicted was dismissed. All charges in the indictment (except the one to which the borrower pled guilty; see below) relate to an alleged scheme, devised by the real estate agent/business broker, to facilitate a \$326,000 SBA-guaranteed loan to the borrower for his purchase of a forklift sales and repair business in Parma, Ohio, from the two sellers of the business. The scheme to fraudulently provide the borrower with the funds for his required capital injection prior to the loan closing enabled all the defendants to benefit from the completion of the transaction. It essentially provided the borrower with 100 percent financing and resulted in inflation of the contract sales price, thereby exposing SBA and the participating lender to additional loss and reduced recovery potential. The benefit to the sellers was the sale of their business; the benefit to the real estate agent/business broker was her commission. This scheme to defraud SBA and the participating lender was also facilitated by each of the subjects' concealment of the transfer of funds from the sellers to the borrower, and their supporting false statements to the participating lender and SBA.

The count to which the borrower pled guilty charged him with certifying, in the loan application he submitted to SBA and the participating lender, that he had no criminal history. The investigation revealed that he had been arrested and charged with various crimes; these charges resulted in four convictions prior to his loan application, including one felony conviction for first-degree burglary. OIG initiated this investigation based upon a referral from SBA's Cleveland District Office.

Virginia Chiropractor Pleads Guilty to Making False Statements Under Oath in Bankruptcy. A Virginia Beach, Virginia, chiropractor pled guilty on September 20, 2001, to a one-count information charging him with **making a false statement under oath in bankruptcy**. He had submitted false equipment invoices and a false building lease in support of his application for a 1996 SBA-guaranteed loan of \$337,000 to purchase equipment. Upon receiving the two-payee disbursement checks for the loan, he forged the endorsement of the equipment company and deposited the checks into his personal account. He subsequently defaulted on the \$136,617 balance of the loan. His scheme was revealed when he filed for bankruptcy in 1999. OIG's joint investigation with the Federal Bureau of Investigation was based on a referral from the U.S. Bankruptcy Trustee in Norfolk, Virginia.

Michigan Company President Sentenced for Bank Fraud. On September 4, 2001, the president of a Rochester Hills, Michigan, company was sentenced to 1 day of incarceration and \$136,516 restitution. He previously entered a guilty plea to 1 count of **bank fraud** in connection with a \$750,000 line of credit loan guaranteed by SBA. The loan proceeds were designated for specific projects approved by the participating lender bank. The disbursement process consisted of the defendant faxing (or authorizing the faxing of) disbursement requests on the line of credit, along with copies of checks designated for suppliers or other payees, to the bank. The bank would then credit the company's checking account for the amount requested. On 27 occasions, the defendant submitted false information to the bank to obtain disbursements totaling over \$386,000 on his SBA line of credit loan. OIG initiated its joint investigation with the Secret Service based on a referral from the bank through SBA's Michigan District Office.

California Businessman Indicted for Making False Statements to SBA. A California businessman was indicted on October 23, 2001, on three counts of **making false statements to SBA**. He allegedly submitted false and fraudulent documents to obtain a \$90,000 SBA-guaranteed LowDoc loan from a non-bank lender. Those documents included a fictitious invoice for tenant improvements at one of his business locations from a non-existent construction company as partial proof of his required cash injection. Some tenant improvements were actually made; however,

his cousin, who was not a licensed contractor in the State of California, made them. The defendant also allegedly sent a facsimile cover sheet to the lender's loan packagers listing the fictitious invoice as paid. He then defaulted on the SBA-guaranteed loan. The current outstanding balance is \$75,802.25. OIG special agents arrested him on November 1, 2001. OIG initiated the investigation based on a referral from SBA's Los Angeles District Office.

California Produce Business Owner Arrested.

A California produce business owner whose Los Angeles, California, business had received a \$225,000 SBA-guaranteed bank loan in 1999 was arrested on September 13, 2001, by OIG special agents and Los Angeles Police Department officers. He had been a fugitive since 1984, wanted on a Nevada felony warrant for **leaving the scene of an accident** in which an Air Force pilot he ran into was disabled. The defendant had pled guilty to that charge (in return, his "driving under the influence" charge was dropped) but, facing a 1- to 6-year prison term, fled prior to his sentencing. His SBA-guaranteed loan had come under scrutiny in the spring of 2001. A resultant **criminal-history check**, processed by OIG's Office of Security Operations in support of the investigation, disclosed his lengthy criminal record, including (in addition to the Nevada warrant) charges of **carrying a concealed weapon, possession of a controlled substance for sale, and alien smuggling**. He also had entered the United States illegally, and the Immigration and Naturalization Service had denied his application for permanent-resident status in 1993 because of his criminal record.

In applying for his SBA-guaranteed loan, OIG's investigation found that he falsely declared he was a U.S. citizen and falsely answered "No" to the criminal-history questions on SBA Form 912. Believing that the owner of the produce business was the fugitive from the Nevada felony warrant, OIG contacted the Clark County (Nevada) District Attorney's office, which provided confirming booking photos and fingerprints and committed to prosecute him if he were arrested and extradited. Both of those events have now happened. OIG's investigation is continuing.

Government Contracting and Business Development

Missouri Contractor's Indictment Unsealed. An indictment against the president of a Poplar Bluff, Missouri, contractor that had been sealed when the grand jury returned it on August 16, 2001, was unsealed on September 14, 2001. The indictment charged him and his corporation with four counts of **major fraud against the United States**; it also charged him with two counts of **obtaining illegal kickbacks**, three counts of **mail fraud**, and three counts of **making material false statements**. SBA/OIG's joint investigation with the Department of Labor's OIG and the Federal Bureau of Investigation focused on allegations that he used intimidation or threats against two employees of his company in order to obtain part of their compensation during a Government construction project. Further, he allegedly used the U.S. mail to obtain money from various insurance companies by false pretenses. Finally, he allegedly submitted false statements and fraudulent documents to SBA in a scheme to obtain Section 8(a) status and resultant contracts, falsely claiming to be Cherokee Indian and to have suffered consequent economic disadvantage. His Section 8(a) application also allegedly concealed his criminal record for assault. The indictment charged that the company was awarded contracts in excess of \$1 million with the Army Corps of Engineers, the Department of Defense, and the Department of Transportation because of his fraudulent representations.

Entrepreneurial Development Programs

OIG Issues Audit Report on Vermont Women's Business Center. On September 19, 2001, OIG issued an **audit report on a Vermont Women's Business Center**. SBA partially funds the center through a 5-year cooperative agreement with a Vermont college. The audit covered the first year and a half of the center's operations and focused on the financial aspects of the cooperative agreement. The audit identified issues related to: (1) inadequate financial management of the award, (2) insufficient cash match, (3) unallowable expenditures and in-kind contributions, and (4) inaccurate and inconsistent financial information submitted to SBA. As a result, OIG

recommended that the college remit \$36,185 to SBA. The Associate Administrator of the Office of Women's Business Ownership and the Acting Assistant Administrator for Administration ((A)AA/A) agreed with the findings and recommendations.

Surety Bond Guarantee Program

OIG Issues Audit Report on Pennsylvania Surety Company. On September 21, 2001, OIG issued an **audit report on a Philadelphia, Pennsylvania surety company** and found that the surety correctly calculated and timely remitted fees to SBA. The audit also found that the surety did not always comply with SBA regulations for underwriting and servicing bonds and processing claims. More specifically, the company did not: (1) maintain copies of invoices or other proof of claim to support claim payments for two bonds, (2) request and maintain status reports for one bond, and (3) notify SBA in a timely manner of the principal's default for one bond. As a result, OIG recommended that the Associate Administrator, Office of Surety Guarantees, take appropriate actions to recover \$49,916.51 from the surety and advise the surety to implement policies and procedures to correct the deficiencies. The Associate Administrator, Office of Surety Guarantees, agreed with all of the final recommendations.

Agency Management

OIG Reviews Agency Use of Hired Car Services and Home-to-Work/Work-to-Home Transportation. OIG completed a review on September 27, 2001, of SBA's **use of hired car services and home-to-work/work-to-home transportation** provided to senior SBA officials as a result of a Senate Small Business Committee request. OIG reviewed this activity from FY 1998 through January 19, 2001, the timeframe in which the former Administrator and Deputy Administrator utilized the services. OIG identified areas where SBA's Office of Administrative Services (OAS) could improve its management over hired car service(s) and Government vehicles. OAS lacked adequate controls to ensure that SBA was paying the appropriate amount for hired car services and that Government vehicles were used only for official Government business. Also, OAS permitted non-government employees to operate Government

vehicles, which increased the liability to the Federal Government, and it did not enter into a contract for hired car services although the annual cost exceeded the amount whereby contracts are required. The Acting Assistant Administrator for Administration generally agreed with the findings and will take corrective measures.

OIG Issues Advisory Memorandum on SBA's Computer Security Program. OIG issued an advisory memorandum report on SBA's **computer security program** as part of the Government Information Security Reform Act (GISRA) for 2001 on September 28, 2001. GISRA requires an independent evaluation of SBA's computer security program. OIG concluded that while SBA generally maintains a satisfactory information security program for its high priority financial management and general support systems, improvements were needed. SBA has not conducted computer security testing, has no formal computer security program monitoring to ensure that corrective actions are implemented, and did not have adequate disaster recovery and contingency planning. These vulnerabilities will require continued management emphasis in information security with the appropriate underlying resources to ensure that the security and continuity of SBA systems will be improved. The report included recommendations to the Chief Information Officer (CIO) to establish a security system testing program, upgrade computer security monitoring capabilities, and fully implement disaster recovery and contingency planning along with several other recommendations to strengthen SBA's administration of the computer security program. The CIO agreed with the recommendations in the report.

OIG Issues Audit Report on SBA's UNIX Operating Systems. OIG issued an audit report of SBA's **UNIX Operating Systems** on September 28, 2001. OIG audited 13 UNIX servers that support SBA high-priority computer systems. OIG concluded that the security settings and operational controls over the UNIX operating systems were not adequate to prevent or detect unauthorized access to programs and data, and did not comply with Federal and Agency information security requirements. Specifically: (1) access controls were not adequate to protect or detect unauthorized access to the UNIX operating systems; (2) required security documentation had not been properly prepared; (3) security settings and UNIX patch levels had not been maintained; and (4) system

logs had not been consistently reviewed. As a result, there was an increased risk of unauthorized modification, loss, and disclosure of data and programs. The report includes 12 recommendations to improve the security of SBA's UNIX operating systems. The CIO generally agreed with the findings and recommendations in the report and corrected configuration and access control issues during the audit.

Office of Inspector General

OIG managers held an off-site strategic planning meeting. As the part of the OIG's Strategic Plan process, several OIG managers have participated in a series of meetings to develop the 2002 operating plan and the 2003 performance plan.

OIG Employees Receive Recognition for Outstanding Work. Richard R. Smith, the former Assistant Inspector General for Investigations, was recognized by the President's Council on Integrity and Efficiency (PCIE) with the June Gibbs Brown Career Achievement Award. The award recognizes Mr. Smith's 33 years of dedicated public service and his outstanding work combating corruption and upholding the integrity of Government programs and officials.

PCIE also recognized 18 members of OIG with an Award for Excellence. The award was presented for the team's review of the Small Disadvantaged Business Certification Program involving allegations of misappropriation of funds and criminal and administrative misconduct. Their effort resulted in the identification of over \$8 million in recommended and actual funds put to better use. This review was a multi-division project, with staff from the Auditing, Investigations, and Counsel divisions participating.

OIG Semiannual Report to Congress. OIG submitted its Fall 2001 Semiannual Report to Congress to the Administrator for review. As required by the IG Act of 1978, the head of the Agency must transmit the report to Congress within 30 days of receipt, which translates to November 30, 2001. The report highlights OIG activities for the period of April 1 through September 30, 2001. Significant office-wide accomplishments for this 6-month period include: \$3,625,931 in potential investigative recoveries and fines; \$18,182,958 in loans not made as result of investigations and name checks; \$250,287 in disal-

lowed costs agreed to by management; and \$4,530,161 in recommendations that funds be put to better use agreed to by management.

OIG has established an e-mail address (oig@sba.gov) that we encourage the public to use to communicate suggestions for possible audits, or referrals of possible incidents of waste, fraud, or abuse.

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

Comments or questions concerning this Update or request for copies of OIG audits, inspections, and/or other documents should be directed to:

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Many audit and inspection reports can be found on the Internet at
<http://www.sba.gov/IG/igreadingroom.html>

If you are aware of suspected waste, fraud, or abuse in any SBA program, please call the:

OIG FRAUD LINE at (202) 205-7151
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