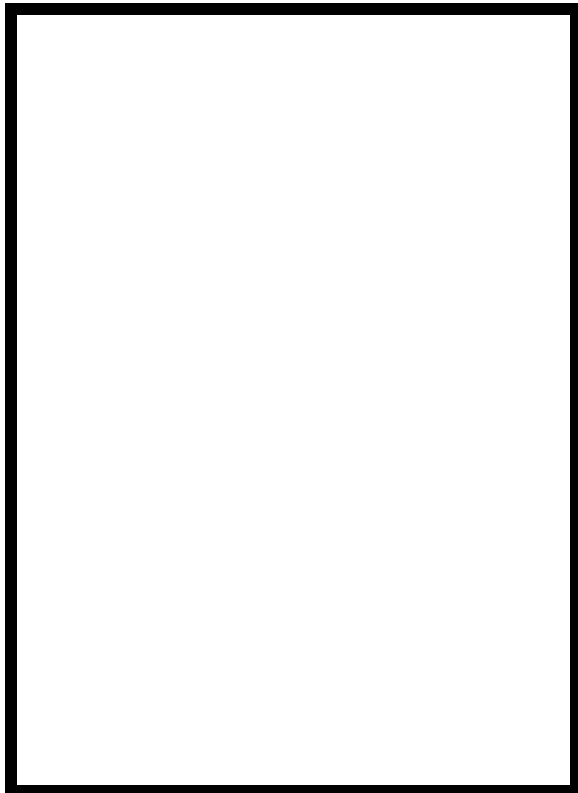




Office of Inspector General Small Business Administration

December 1997 Update



Inspector General James F. Hoobler, a distinguished and innovative public

official for over 35 years, died of acute respiratory failure on December 22, 1997, at Georgetown University Hospital. He was appointed Inspector General of the Small Business Administration in 1991. He was 59 years old.

Dr. Hoobler's public service career spanned three decades during which his leadership and management skills have been widely recognized. He personified the professional Government manager who was able to bring his expertise and intelligence to a diverse range of public policy arenas. He began his career at the Central Intelligence Agency and moved to a series of progressively senior positions at the Department of Justice, the Department of Energy, the Veterans Administration, the Office of Management and Budget, the Department of State, and the Small

Business Administration.

Throughout his remarkable career, Dr. Hoobler was a consistent advocate for making public employees more professional and for making public institutions more accountable. As a recognized authority on strategic planning and resource management, Dr. Hoobler was a frequent writer and lecturer on public policy and performance management. His greatest contribution to public service is the legacy of his former employees and colleagues whom he has mentored and who continue in Dr. Hoobler's tradition of dedicated public service.

Dr. Hoobler was born in Rochester, New York, and received his B.S. degree from Kent State University and his M.A. and Ph.D. from the University of Maryland at College Park. He is survived by his wife, Mary; his parents, Frank and Jean; and his sister, Gail.

Business Loans

Audits Find Record Keeping and Other Deficiencies at Three Nevada Certified Development Companies (CDC).

Audits of three CDCs in Nevada found deficiencies in project record keeping. While the companies generally complied with Section 504 loan program policies and procedures, their files were sometimes missing evidence of site visits, capital injection, construction phases, borrower repayment ability, and independent project appraisals. The audits covered three CDCs that had made in excess of 712 loans valued at over \$228 million since the inception of the program. The OIG sampled 31 loans valued at \$18.2 million.

At one of the three CDCs, compensation practices for two employees gave the appearance of conflict of interest because the employees received direct compensation relating to each loan approval. One employee received commissions, the other received fees.

OIG auditors recommended that the CDCs maintain loan files in accordance with SBA's requirements and disclose to SBA any financial arrangements which would give the appearance of a conflict of interest. The Deputy District Director stated he discussed these problems with at least one of the CDC presidents who has begun to take steps to improve operations.

Auditors also recommended that the Las Vegas District Director (DD) direct each of the CDCs to maintain their loan files in accordance with SBA's SOP 50 22 3. The DD and the CDCs concurred.

California Realtor Pleads Guilty to Bribery of SBA Employee.

A Glendale, California, real estate salesperson pled guilty on December 12, 1997, to 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 the woman 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 offered the loan assistant \$3,500

for the real estate listing. At a later face-to-face meeting, the woman gave the loan assistant \$1,000 as good faith money, and she and the SBA employee signed the real estate listing agreement.

The following day, she 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, the woman denied ever personally meeting with the SBA loan assistant, making him any promises, or giving him any money. Other evidence contradicted those denials.

Georgia Grocer Indicted for Making Materially False Statement. The president and owner of a grocery store in Kennesaw, Georgia, was indicted on December 2, 1997, on one count of **making a materially false statement** in an SBA-related matter. His company had obtained a \$155,000 SBA-guaranteed loan in May 1995. On the Statement of Personal History, SBA Form 912, submitted as part of the loan application package, the owner certified that he had never been arrested. The OIG's investigation revealed, however, that he had been arrested twice. This investigation was initiated based on a referral from SBA's Atlanta District Office.

Two Kansas Building Material Manufacturers Indicted for Making False Statements. Two former owners and officers of a building-materials manufacturing company were indicted on December 16, 1997, on three counts of **making false statements to SBA** and **making false statements to a Federally-insured lender** regarding its application for a \$630,000 SBA-guaranteed loan. The loan was

intended to finance the opening of a plant in Neodesha, Kansas, to manufacture foam-core construction panels, but the business failed and defaulted on repayment of the loan. The OIG's joint investigation with the U.S. Secret Service determined that, to obtain the loan, the two men misrepresented that the first was the president and 100% owner of the company. It was the second man, however, who actually was the corporation's president and 100% owner at the time. This investigation was initiated based on a referral from SBA's Kansas City District Office.

Kansas Couple Indicted for Making False Statements. The president and the secretary of a fuel-pellet manufacturing company in Erie, Kansas, were indicted on December 16, 1997, on three counts of **making false statements to SBA** and **making false statements to a Federally-insured lender** regarding the company's application for a \$147,650 SBA-guaranteed loan. The loan was intended to finance the opening of a fuel-pellet manufacturing plant, but the business failed and defaulted on repayment of the loan. The OIG's joint investigation with the U.S. Secret Service determined that the man failed to disclose a prior defaulted SBA disaster loan and prior bankruptcy, and the couple failed to disclose fuel taxes they owed to the State of Arizona. This investigation was initiated based on a referral from SBA's Kansas City District Office.

California Brokerage Principal Indicted for Bank Fraud and Making False Statements. A principal of a San Jose, California, loan brokerage firm was

indicted on December 19, 1997, on 1 count of **bank fraud**, 11 counts of **making false statements on loan applications to Federally-insured financial institutions**, and 6 counts of **making false statements** to obtain SBA-guaranteed loans. The indictment was the result of a joint investigation, conducted by the OIG and the FBI, that was initiated based on information provided by SBA's San Francisco District Office. In the indictment, the man was charged with submitting false documents to assist his clients in obtaining SBA-guaranteed loans to purchase convenience stores in northern California. The allegedly false documents he submitted generally involved the applicants' eligibility and/or source of down payments and included personal financial statements that overstated the applicants' net worth. The indictment also charged that the man frequently used "straw" applicants to conceal the true identity of principals who would not have been eligible for SBA-guaranteed loans. Some were ineligible because they were not permanent legal U.S. residents, and some would have exceeded SBA's per-person loan maximum. Cited in the indictment are a total of 10 loans made by a Sacramento bank between 1989 and 1995 and 1 loan made by another California bank in 1997. Together, they total nearly \$6 million. To date, SBA has paid out over \$1.8 million to repurchase defaulted loans made to his clients.

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Disaster Assistance

California Pharmacy Owner Sentenced

for Making False Statement. The former owner of a pharmacy in Sherman Oaks, California, was sentenced on December 22, 1997, to 3 years probation, 300 hours community service, and a \$1,050 fine. He was also ordered to continue making timely payments on all his SBA disaster loans.

The man had pled guilty to one count of **making a false statement** to SBA. Based on a referral from SBA's Santa Ana Loan Servicing and Liquidation Center, an investigation was initiated into allegedly false financial information given to SBA in support of three disaster loans. The store owner had received a \$100,000 disaster home loan (following the 1993 severe winter storms), a \$45,000 disaster home loan, and a \$218,000 disaster business loan (following the 1994 Northridge earthquake). In 1996, he requested that SBA release its lien on his business assets. Information supporting the request contradicted information in his loan applications, and the investigation revealed that he had given SBA fictitious Wage and Tax Statements (Form W-2), altered Individual Income Tax Returns, a fictitious S Corporation Income Tax Return, and a fraudulent Corporation Profit and Loss Statement.

Texas Computer Services Company Owner Sentenced for Forgery.

The owner of a computer services company in Clute, Texas, was sentenced on December 5, 1997, to 4 months incarceration, 6 months home confinement, 30 months supervised release, \$22,000 restitution, and a \$150 special assessment. He previously pled guilty to three counts of **forging endorsements on U.S. Treasury checks**, which represented a portion of

the proceeds of a \$183,400 economic injury disaster loan his business had obtained from SBA. The man fraudulently negotiated three Treasury checks (totaling approximately \$27,000), each jointly-payable to himself (doing business as the computer services company) and another business whose endorsement was falsely made. The indictment resulted from an OIG investigation based on a referral from SBA's Houston District Office.

Pennsylvania Businessman Pleads Guilty to Making False Statement. The owner of two Williamsport, Pennsylvania, businesses pled guilty on November 25, 1997, to a one count information that charged him with **making a false statement** to SBA by omitting from his application for disaster assistance a mail fraud charge to which he had agreed to plead guilty. The false statement was made in connection with his application for disaster loans, totaling \$78,300, relating to floods in the Susquehanna River valley in January 1996. SBA declined the loans after discovering the undisclosed criminal charge. The investigation, which the OIG worked jointly with the FBI, was based on information provided by SBA's Disaster Assistance Area 3 Office.

California Fashion Store Owner Pleads Guilty to Making False Statement. The former owner of a fashion store in Los Angeles, California, pled guilty on November 24, 1997, to the one count of **making a false statement** to SBA on which he had been indicted. The OIG initiated the investigation based on a referral from SBA's Santa Ana Liquidation Center and continued it

jointly with the U.S. Secret Service. Following the 1992 civil unrest, the man had obtained two SBA disaster loans for the business. The investigation revealed that, in support of his applications for an \$87,300 physical damage loan and a \$28,100 economic injury loan, he had submitted copies of tax returns that had been altered to overstate his income. SBA would not have made the disaster assistance loans had his true financial condition been known; his fraudulent activity resulted in a \$77,000 loss to SBA.

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Small Business Investment Companies

California Specialized Small Business Investment Company (SSBIC) Chairman Charged With Conspiracy and Misapplication of Funds. The chairman of the board of a now-defunct Westminster, California, SSBIC was charged on November 28, 1997, with one count of **conspiracy** and three counts of **willful misapplication of funds** belonging to the SSBIC. These charges are the culmination of an extensive investigation initiated in 1992, based on information provided by SBA's Investment Division shortly after \$1 million in SBA funds were advanced to the company. The investigation found that the man made false statements with respect to his initial cash injection, the true ownership of the small business concerns to which the \$1 million was loaned, and the disposition of the loan proceeds. He recently repaid \$927,000 of the \$1 million he fraudulently obtained from SBA in April 1992. In addition, based on information

developed in the investigation, the company's receiver negotiated out-of-court settlements with both a bank and the bank's operations officer, for \$150,000 and \$50,000, respectively, for their assistance to the chairman in manipulating the SBA funds.

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Economic Development (Training)

Hawaiian Small Business Development Center (SBDC) to Improve Counseling and Fund Raising Practices.

Improvements in counseling services and fund raising were recommended by the OIG in an audit of a Hawaiian SBDC's operations during 1995. Although counseling services are considered the major service of the SBDC program, the center averaged only 15.6 percent of total staff hours providing counseling services. The audit also found that funding cuts by its sponsoring university made it important that the center develop new funding sources.

The audit report recommended that the Honolulu District Director (DD) require the SBDC to submit a plan to increase counseling hours and to increase fund raising from private sector and local government entities. The DD said that the center compared favorably to other SBDCs when counseling, training, advocacy, and research are considered, but he directed the SBDC to develop a plan to maximize client service delivery. The SBDC director disagreed that counseling is the primary SBDC service, but agreed to enhance

client service delivery in the next annual strategic plan. The DD and the SBDC director concurred with the fund raising recommendation.

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Agency Management and Financial Activities

Inspection Report Finds that Some Agency Programs Do Not Always Collect Information Necessary for OIG to Conduct Criminal History Checks and IRS Tax Verifications on Applicants.

The OIG issued an inspection report that assesses the use of criminal history and tax verification information to detect fraud in SBA programs. The inspection found that the Office of Disaster Assistance (ODA) and several of the specialized loan guarantee programs neither use the Statement of Personal History (Form 912) nor collect the information necessary for the OIG to conduct criminal history checks on applicants. Given evidence that a significant number of applicants fail to disclose their prior criminal records when applying for SBA financial assistance, the OIG recommended that the Office of Financial Assistance (OFA) and the ODA obtain the information necessary for the OIG to perform criminal history checks.

Although SBA requires that financial data submitted by applicants and participants in the Section 7(a) and Section 8(a) programs be verified using tax information from the Internal Revenue Service (IRS), the inspection found that Section 7(a) lenders and

Minority Enterprise Development (MED) officials do not always request the IRS verification data. The OIG recommended that OFA develop procedures to ensure that all loan applicants' tax returns and financial statements are verified with IRS information prior to loan disbursement and that MED officials revise program procedures to require IRS verification in processing electronic application and in establishing a firm's continuing eligibility for the Section 8(a) program.

The OIG also found that SBA's Size Standards and Surety Guarantee programs, each of which make decisions that are highly time-sensitive, do not obtain verification information due to the occasional delays expected in IRS responses. The OIG recommended permanent use of tax verification in the Size Standards program and a one-year pilot test in the Surety Guarantee program, with the provision that both be allowed to issue conditional approval in cases where the IRS does not meet the programs' time constraints.

Former SBA Employee Charged With Embezzling Government Funds. A former SBA employee from Van Nuys, California, was charged in an information on December 1, 1997, with two counts of **theft of Government property**. The SBA/OIG's joint investigation with the OIG of the Federal Deposit Insurance Corporation (FDIC), where he was previously employed, found that after the man was hired as a loan specialist by SBA's Los Angeles District Office in 1995, he embezzled at least \$64,929 in disaster loan payments due SBA. In most of the cases, it is alleged, he falsely told

delinquent borrowers that SBA had turned over their files to a collection agency to which he directed the borrowers to make their payments. The collection agency was actually an entity the employee controlled. The investigation also found that he had embezzled \$5,883 from the FDIC by depositing a payment due the FDIC into a bank account under his control. The SBA/OIG initiated its investigation based on a referral from SBA's Santa Ana Home Loan and Liquidation Center, to which the employee had been transferred in 1996.

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OIG Management

New Assistant Inspector General for Investigations Appointed. The Office of Inspector General (OIG) is pleased to announce the appointment of Richard (Rick) Smith as its new Assistant Inspector General for Investigations (AIGI). Mr. Smith is presently the Special Agent in Charge of the St. Louis, Missouri, field office of the Defense Criminal Investigative Service. He has 25 years of investigative experience and extensive management and supervisory experience. In addition, he brings to the AIGI position a variety of skills and experience including strategic and budgetary planning and execution, training, media relations, employing the computer as an investigative tool, and developing innovative methods to detect and deter fraud. Mr. Smith holds a B.S. degree from Bemidji State University and has completed numerous investigative and management training courses. He

replaces Stephen Marica, who accepted a position with the Internal Revenue Service. Mr. Smith will be joining the SBA OIG in mid February.

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

The Activity Update is produced by the SBA/OIG, Karen S. Lee, Acting 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.

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