



Office of Inspector General Small Business Administration

January 1999 Update

Business Loans

Missouri Banker Indicted for Making False Statements and Claims. The indictment of an officer of a participating lender bank in Springfield, Missouri, was unsealed on January 12, 1999. The banker was charged with one count each of **making false statements to SBA, making false entries in the records of a Federally insured bank, and making a false claim** against the United States. All the charges related to the banker's actions on a \$155,000 SBA-guaranteed loan issued in 1995 to a music retailer. After the borrower defaulted on the loan and filed bankruptcy, SBA paid the bank \$117,002 on its guarantee. According to the indictment, the bank officer filed a false application for the SBA-guaranteed loan, stating that certain outstanding bank loans to the borrower were current, when in fact they were delinquent. It was further alleged that the banker made false entries in the bank's records by stating that the SBA-guaranteed loan proceeds would be used to pay down delinquent trade accounts; in fact, a substantial portion of the loan proceeds was used to bring existing bank loans current. Finally, the indictment charged that, after the borrower defaulted, the banker made a false claim against SBA for payment of the full guarantee on this loan, when she knew the guarantee was unenforceable because it had

been obtained by means of a false application. (Updated from the July 1998 Update.)

Missouri Lender Settles Civil Fraud Case. A civil fraud complaint was filed against a Springfield, Missouri, bank on January 19, 1999. The bank settled the matter on that same date by agreeing to pay the Government \$244,000, plus \$16,286 as reimbursement for Federal investigative costs. The complaint charged the participating lender with **making a false claim** in connection with a \$155,000 SBA-guaranteed loan to a music retailer. The complaint detailed alleged fraudulent actions by a bank officer (see above) and also named another bank officer for allowing the false information to be submitted to SBA. In July 1998, the former president of the borrower pled guilty to making false statements to SBA by misrepresenting on the loan application that loans from the lender were current. The OIG initiated this joint investigation with the Federal Bureau of Investigation (FBI) based on a referral from SBA's Springfield, Missouri, Branch Office. (Updated from the July 1998 Update.)

Investigation of California Loan Brokerage Firm Yields Further Results. Two more actions have resulted from an ongoing investi-

gation of an Ingelwood, California, loan brokerage firm.

1 The owner of a car wash in Lomita, California, was sentenced on November 2, 1998, to 5 months in prison, 5 months home detention, 5 years supervised probation, and \$70,000 restitution (of which 75% comes to SBA). The man previously pled guilty to **making a false statement to a Federally insured lender** by submitting altered Individual Income Tax Returns for the years 1987-89 with his application for a \$1,000,000 SBA-guaranteed loan. He also submitted altered tax returns for 1990 and 1991 in response to the requirement to provide information about his financial condition throughout the time that the loan was in force. *(Updated from the April 1998 Update.)*

2 A husband and wife who were former owners of a West Covina, California, gas station pled guilty on January 28, 1999, to four counts of **making false statements to a Federally insured financial institution**. The investigation disclosed that the couple submitted to the participating bank altered Federal income tax returns for the years 1988 and 1989 with their application for a \$1,000,000 SBA-guaranteed loan. 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 May 1998 Update.)*

California Restaurateur Sentenced for Making False Statement to a Federally Insured Financial Institution. The owner of a restaurant in Palm Springs, California, was sentenced on

January 11, 1999, to 1 year of probation and a \$2,000 fine. No restitution was ordered because the loan is current. The man previously pled guilty to one count of **making a false statement to a Federally insured financial institution**. The OIG initiated the investigation based on an allegation from a confidential source that the man had submitted altered copies of tax returns in support of his application for an SBA-guaranteed business loan. The investigation revealed large discrepancies between the tax returns provided to the participating lender bank and those submitted to the Internal Revenue Service (IRS). *(Updated from the November 1998 Update.)*

California Tax Preparer Charged with Conspiracy to Defraud Internal Revenue Service and Tax Evasion. A tax preparer in Pasadena, California, was charged on January 21, 1999, with 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 to the participating bank 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 just filed against him were a direct result of the evidence gathered during the search. The investigation is continuing.

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Disaster Assistance

Two Former SBA Loss Verifiers Charged with Making Material False Statements. Felony charges of **making a material false statement** have recently been brought against two former loss verifiers in SBA's Disaster Assistance Area 4 Office. One man was charged with one count in a criminal information filed on December 7, 1998, and the second man was charged with two counts in a criminal information filed on December 24, 1998. Following the January 1995 flooding in the Sacramento, California area, the second man had applied to both SBA and the Federal Emergency Management Agency (FEMA) for disaster assistance in connection with his home. During March 1996, he allegedly submitted false contracts, invoices, and checks purportedly evidencing repairs by and payments to the first man, who was a SBA employee at the time and a licensed contractor, to obtain a \$57,400 SBA disaster loan. The second man allegedly also submitted some of these false documents to FEMA in January 1997 as proof that the first man had repaired the 1995 disaster damage and that any damage observed in 1997 resulted from the 1997 disaster. The first man was charged with making false statements to SBA and FEMA investigators by fraudulently misrepresenting that he had performed and been paid for the disaster repairs. The case resulted from a referral from the FEMA OIG and was conducted jointly. The disaster loan is current.

Canadian Football League Player Indicted for Mail Fraud. A Canadian Football League player was indicted on January 21, 1999, on seven counts of **mail fraud**. Following the January 1994 Northridge earthquake, he had obtained a total of \$396,100 in SBA disaster loans (one for physical damage, the other for economic injury) for his Artesia, California, computer business. The investigation revealed his business suffered no loss of any inventory

and the man diverted loan funds to his personal use, which included the purchase of another business. In addition, he allegedly failed to disclose to SBA that the computer business had closed in September 1994, 1 month prior to his last loan disbursement of \$96,200. Upon learning that a warrant for his arrest had been issued, the man fled to Canada. He was recently arrested in Canada on immigration-violation charges and is currently awaiting a hearing with Canadian immigration authorities to determine if he will be extradited to the United States. The OIG initiated this investigation based on a referral from SBA's Disaster Assistance Area 4 Office.

California Businessman Indicted for Making Material False Statement. A Canoga Park, California, businessman was indicted on January 22, 1999, on two counts of **making material false statements**. After the Northridge earthquake, the man had obtained SBA disaster loans (for physical damage and for economic injury) totaling \$55,700 for his businesses. (One was a printing business; the other was a four-unit apartment complex.) He also received a \$12,000 SBA disaster home loan for real estate and personal property losses to one of the Canoga Park units, where he resided during the earthquake. The investigation revealed that he failed to disclose to SBA that he had filed for bankruptcy in 1989 and 1990 under a different name and Social Security Number. The man also failed to inform SBA that he was on probation at the time he applied for the disaster loans. The OIG joined the investigation, which was initiated by the Bureau of Alcohol, Tobacco and Firearms as an inquiry into possible arson. The investigation also expanded to include the OIG of the Social Security Administration.

California Businessman Charged with Making False Statement to a Federally Insured Financial Institution. A Canoga Park, California, man was charged on January 7,

1999, with one count of **making a false statement to a Federally insured financial institution**. Following the 1994 Northridge earthquake, the man had received a \$48,000 disaster home loan from SBA for damage to his personal property and condominium. Later in 1994 he received a \$255,950 SBA-guaranteed loan for the purchase of a laundromat in Huntington Park, California. The OIG initiated its investigation based on a referral from SBA's Disaster Assistance Area 4 Office. The investigation disclosed that, in applying for the business loan, the man submitted false statements to the participating lender bank. He claimed to be employed at a salary of \$52,000; in fact, he was unemployed at the time and had never been employed by the named employer. He also did not disclose to the bank that, in violation of the requirement to use non-borrowed funds, he had used proceeds from the disaster loan as the source of the down payment for the purchase of the laundromat. The investigation further revealed that the man had submitted false information to SBA in support of the loss of personal property in the disaster home loan. The investigation showed that most of the personal property claimed as damaged had actually been moved to another site. SBA loss verifiers were shown only minor broken items and were told that the rest had been cleared away prior to their visit. Both loan balances were charged off after his subsequent Chapter 7 bankruptcy discharge; the total loss to SBA was approximately \$245,000.

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Small Business Investment Companies

President of a New York Small Business Investment Company Indicted for Bank Fraud, Misapplication of SBIC Funds, and Making Material False Statements. The president of a New York, New York, small business

investment company (SBIC) was indicted on January 19, 1999, on charges of **bank fraud, misapplication of SBIC funds, and making material false statements**. The indictment charged that from March 1996 through February 1997 the man fraudulently obtained over \$750,000 in loans from the SBIC, as well as over \$250,000 in salary advances. According to the indictment, he caused the SBIC's vice president to co-sign the salary advance and loan checks by falsely representing that the loans were permissible under SBA regulations. The man claimed that the funds were to be used to purchase his estranged wife's interest in the SBIC, in order to prevent her from gaining control of the company. He subsequently made false representations to SBA on several occasions, unsuccessfully seeking the Agency's retroactive approval for the loans and advances. He then allegedly used the fraudulently obtained funds for unauthorized purposes, including repayment of his personal gambling debts and personal debts to the two other members of the SBIC's loan committee. His actions caused the SBIC to fail and forced the Agency to begin liquidating the SBIC in 1997. SBA expects to lose \$1.4 million as a result of this failure. The investigation, conducted jointly with the FBI, originated from a referral by SBA's Office of SBIC Operations.

Four Men Involved with New York Specialized Small Business Investment Company Convicted of Conspiracy. A Federal jury convicted four leaders of an incorporated Hasidic community in Rockland County, New York, on January 25, 1999, on the 21 counts on which they had been indicted. The men had been charged with **conspiracy, embezzlement of Federal program funds, making material false statements, mail fraud, wire fraud, mortgage fraud, and money laundering**. The 5-year investigation disclosed that the defendants had participated in a

number of fraudulent schemes to obtain tens of millions of dollars through SBA's Specialized Small Business Investment Company (SSBIC) program and other Federal and state grant, loan, and subsidy programs. SBA's liquidation of the SSBIC concluded more than 1 year ago; the SSBIC repaid SBA \$1.1 million of the \$1.2 million of leverage funding provided by SBA. The U.S. Attorney's Office for the Southern District of New York asked the SBA/OIG to join its ongoing investigation with the IRS and the OIGs of the Departments of Education and Housing and Urban Development. A fifth defendant, who had fled to Israel after being indicted with the others, was arrested by Israeli police in late February 1999. The arrest was based on the U.S. arrest warrant that resulted from this indictment. (Update from the May 1997 Update.)

claims. The non-compliances in the application process included circumvention of statutory limits on bond amounts, guarantees issued to a contractor in default on a previous contract, incomplete contractor eligibility determinations, and a guaranteed bond issued for an amount greater than the contract amount. The errors on the claim submission included an improper allocation of expenses caused by a programming error, in which the Surety immediately reimbursed SBA the claim overcharge and corrected the automated worksheet. The audit report recommended corrective actions and recovery of \$795,991. The Associate Administrator for Surety Guarantees agreed with the recommendations.

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Surety Bond Guarantees

Surety Found in Non-Compliance with SBA's Policies on Bond Guarantees and Submission of Claims. An audit of a surety company in Chicago, Illinois, found, in certain instances, there was **non-compliance with SBA's policies and procedures in applying for bond guarantees and submitting claims.** The audit reviewed all of the surety's bonds with claims over \$100,000 during a one and a half year period and an additional 24 current bonds. Specifically, the surety did not follow SBA's procedures for 10 bonds reviewed. Nine of these bonds had application problems, and one of them had claim submission problems. As a result, SBA paid \$795,991 in unallowed

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, Karen S. Lee, Acting Inspector General.

Comments or questions concerning this update or request for copies of OIG audits, inspections, or other documents should be directed to David R. Gray, SBA/OIG, 409 Third Street, SW, Washington, DC, 20416-4110.

Telephone number (202) 205-6580

FAX number (202) 205-7382

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