



Office of Inspector General Small Business Administration

April 1997 Update

Business Loans

OIG Study Evaluates SBA and Lender Loan Liquidation Responsibilities. The OIG issued an inspection report on **Increasing Lender Liquidation Responsibility in the Section 7(a) Business Loan Program**. It explores the potential for increasing Preferred Lender Program (PLP) and Certified Lender Program (CLP) lenders' responsibility for liquidating SBA loans. It concludes that SBA currently has in place adequate regulations, procedures, and other controls to encourage lenders to obtain maximum recoveries and to allow the Agency to take action for negligent liquidation actions. It also found, however, that the SBA does not take full advantage of lender liquidation capabilities. Some districts give lenders a great deal of latitude, while others insist on making many of the liquidation decisions themselves. Given the Agency's reduced resources, the OIG believes it should no longer involve itself in step-by-step liquidation transactions on PLP and CLP defaulted loans. Instead, SBA needs to commit its resources to monitoring the way PLP and CLP lenders are handling these activities.

Washington State Crane Manufacturer Sentenced for Fraud and Money Laundering. The former president of a

Port Angeles, Washington, crane manufacturing company was sentenced on March 21, 1997, to 37 months imprisonment; 5 years probation; restitution of \$43,298 to SBA and its participating lender bank, and another \$390,500 to the bank's investors. He had previously pled guilty to one count of **bank fraud** and one count of **money laundering**. The OIG's joint investigation with the FBI and the IRS found that the businessman made false statements about his criminal history, his Social Security number, and his cash injections into the firm to obtain a \$100,000 SBA-guaranteed business loan. Once the loan was disbursed, the company's president also misused approximately \$12,000 of the loan's proceeds for personal expenses--the payment of his rent and credit card bills. The loan defaulted after he fled the Port Angeles area with the company investors' funds. SBA/OIG and FBI agents subsequently arrested him. The OIG's investigation was initiated after SBA's Seattle District Office referred an inquiry from the Washington State Attorney General's Office.

California Talk Show Host Pleads Guilty to Making False Statement. A Los Angeles, California, businessman and radio talk show host pled guilty on April 8, 1997, to one count of **making a false statement in a loan application to a Federally-insured financial institution.**

The investigation disclosed that the businessman sold land and a building to the owner of a sporting goods store and recreational sports center in Los Angeles, and assisted her with the purchase by signing an escrow modification statement which falsely stated that she had paid him \$160,000 outside of escrow. The \$160,000 "payment" was submitted as evidence to both the participating lender and SBA that she had made the necessary capital injection into the project by purchasing the land and building in which her company was located and thereby qualifying for an SBA-guaranteed loan. The woman had previously been sentenced for fraudulently obtaining a \$1 million SBA-guaranteed business loan to purchase the property in question. Her loan was identified as part of an ongoing series of SBA/OIG and U.S. Secret Service investigations examining applications submitted to SBA lenders by unscrupulous loan brokers and their clients.

Idaho Farm Supply Company President Indicted for Bank Fraud, Money Laundering, and Bankruptcy Fraud. The former president of a Caldwell, Idaho, farm implement business was indicted on April 8, 1997, on 2 counts of **bank fraud**, 1 count of **wire fraud**, 11 counts of **bankruptcy fraud**, and 6 counts of **money laundering**. Also included in his indictment was a demand for **criminal forfeiture** of assets which he allegedly hid from the bankruptcy court. FBI and SBA/OIG special agents arrested the man, and the FBI seized his Range Rover vehicle. The joint SBA/OIG, FBI, and IRS investigation found that the company president made several false statements to obtain a \$750,000 SBA-guaranteed loan, a \$250,000 revolving line of credit, and a \$210,000 short-term

bank loan. The investigation also found that he used over \$1 million of the company's funds for his and his family's personal gain, including purchasing a luxury home and several luxury vehicles. The man then caused the company to file bankruptcy and, during the bankruptcy, allegedly diverted accounts receivable to other bank accounts under his control and hid assets from the bankruptcy trustee by filing false liens on some of the assets he had purchased with company funds. In addition, during a bankruptcy hearing, the company president made several false statements in response to the bankruptcy judge's direct questions. The current loss on the SBA-guaranteed portion of the loan is approximately \$86,000.

California Jewelry Store Owner Sentenced for Making False Statements.

The former owner of a retail jewelry store in San Luis Obispo, California, was sentenced on April 28, 1997, to 21 months imprisonment, 3 years supervised probation, a \$5,050 fine, and \$336,894 in restitution (82.5 percent payable to SBA and 17.5 percent payable to the participating lender bank). He had been convicted of **making false statements to a Federally-insured financial institution**. A lengthy investigation, based on information provided by SBA's Fresno District Office and conducted jointly by the SBA/OIG and the FBI, revealed that the owner submitted fictitious 1986 and 1987 individual tax returns in support of an application for a \$450,000 SBA-guaranteed loan approved in 1988. He subsequently provided fictitious individual and corporate tax returns for 1988-90 and was successful in obtaining another SBA-guaranteed loan for \$100,000. Both

loans ultimately went into default and were liquidated. Following liquidation efforts, a total of \$336,895 was "charged off" by the lender.

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Disaster Assistance

California Video Store Owner/Jeweler Charged with Filing a False Claim. The owner of a Norwalk, California, jewelry shop was charged in a criminal information on April 1, 1997, with one count of **filing a false claim** with SBA. After the Los Angeles videotape rental store she owned was looted and burned during the 1992 civil unrest, the applicant was approved for SBA disaster loans totaling \$185,000 to rehabilitate the business. The OIG's investigation revealed that, as part of the loan application, she submitted a copy of a fictitious 1989 individual income tax return and an altered copy of her 1990 individual income tax return. Both of these documents significantly overstated her income. The investigation also revealed that, instead of using the \$159,700 of loan proceeds to reopen the video store, the woman opened a jewelry store. (SBA canceled the final \$25,300 before it was disbursed to her.) The investigation was initiated based on referrals from SBA's Fresno district counsel and Disaster Assistance Area 4 Office.

North Carolina Disaster Home-Loan Applicant Pleads Guilty to Making False Statements. A disaster home-loan applicant from Waynesville, North Carolina, pled guilty on April 25, 1997, to two counts of **making false statements**

to obtain a \$38,400 SBA disaster home loan. To secure the Agency's approval of her loan application and its disbursement of the initial \$10,000 of the loan, the woman submitted to the Agency a deed of separation from her husband altered to significantly overstate her alimony income. To show how she had spent the \$10,000, the applicant submitted falsified documentation including a purchase order for a mobile home, a certification of hazard insurance, a title insurance policy, and a mobile home certificate of title. Subsequently, she submitted additional false documents, i.e., a purchase contract and two bank statements, to the investigating OIG special agent in support of her disaster-related claims. This investigation was initiated based on a referral from SBA's Disaster Assistance Area 2 Office, and precluded the disbursement of the loan balance.

Texas Automobile Repair Shop Owner Indicted for Making False Statements. The owner of a Fort Worth, Texas, auto repair shop was indicted on April 16, 1997, on four counts of **making false statements to SBA**. Following a December 1991 flood, he had received three disaster loans: a \$16,800 home loan, a \$16,700 business physical damage loan, and a \$12,700 economic injury loan. In applying for the loans, the applicant reported owning \$39,000 in stocks and bonds that the subsequent investigation demonstrated he did not own. He also submitted allegedly false invoices to induce SBA to disburse the final \$6,800 of home loan proceeds. The two business loans are in default, but the home loan is current. This joint investigation by the SBA/OIG and the U.S. Secret Service was opened in response to a referral from SBA's

Disaster Assistance Area 3 Office.

California Market Owner Sentenced for Making False Claim. A former owner of a meat market in Huntington Park, California, was sentenced on February 10, 1997, to 3 months home detention with electronic monitoring, 3 years probation, and a \$50 special assessment. He had pled guilty to one count of **filing a false claim** with SBA. The OIG initiated the investigation of this loan applicant following receipt of a letter from his insurance company. The investigation documented that the man had received a \$174,100 disaster business loan following the 1992 civil unrest in Los Angeles, claiming extensive damage to his store from looting. The loan went into default, however, after only two payments were made. Interviews with numerous witnesses confirmed that no looting took place at the market. When interviewed, the market owner confessed that he had overstated his losses and admitted overstating his income on the fictitious income tax returns submitted in support of the loan application. The IRS had no record of his having filed any tax returns for 1988 through 1991, the years in question.

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Small Business Investment Companies

Receivership of Corruptly-run Specialized Small Business Investment Company (SSBIC) Pays SBA Another \$1 Million. During the half-year that ended on March 31, 1997, the receivership of a Southfield, Michigan, SSBIC, which was ordered as a result of information developed during

the SBA/OIG's joint investigation with the U.S. Secret Service, **paid SBA another \$1 million** generated from its "closing down" of the former licensee's business. This brings the **total recovered by SBA under the terms of the 3-year old receivership to \$4 million.** The SSBIC's former owner was previously sentenced to 1 day's imprisonment and forfeiture of \$50,000 to the Government for receiving an unlawful benefit during the time period he operated the SSBIC. The investigation found that from 1987 through 1992 he solicited and received money, or payment of his personal debts, from prospective SSBIC borrowers in exchange for making loans to their companies.

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Agency Management and Financial Activities

Audit-Related Management Letters Highlight Internal Control Weaknesses. **SBA does not have effective procedures for identifying and reporting internal control weaknesses** as required by the Federal Managers Financial Integrity Act (FMFIA), according to management letters issued in conjunction with the audit of SBA financial statements for FY 1996. The Computerized Internal Control Review system was canceled by the Agency in February 1996 and a task force formed to establish a "more meaningful review process." A new process has not been implemented, however, leaving SBA out of compliance with FMFIA and OMB Circular A-123.

This was one of 10 issues identified in

management letters to the Chief Financial Officer and the Atlanta Disaster Area Office. Other issues concerned verification of field office transactions, documentation of new automated cash reconciliation procedures, reconciliation of SBIC loan balances, SBIC subsidy rate reestimates, collateral appraisals, debt collection procedures, and ethics program reporting.

Pre-Award Audit of West Virginia Grantee Finds Unallowable Costs and Depreciation. A pre-award audit of a West Virginia foundation's grant proposal for \$3 million appropriated under PL 104-208 (9/30/96), questioned \$463,905 of **proposed costs that were unreasonable or unallowable** and need reprogramming to other allowable cost areas.

In addition, the pre-award audit also identified **\$9.7 million in unallowable depreciation** proposed for allocation to Federal grants in future years. Of this amount, \$4,248,000 related to a building paid for by Federal funds for which depreciation is not allowed. The balance related to a commercially-rented building for which depreciation is also inappropriate unless revenue generated is allocated as program income to the Federal grant. The OIG recommended that the foundation prepare a revised proposal which corrected the deficiencies found during the audit. SBA's Assistant Administrator for Administration agreed with the OIG's findings and recommendations.

SBA Employee Pleads Guilty to Misuse of a Social Security Number. A former clerk in SBA's Disaster Assistance Area 4 Office (DAO-4) pled guilty on March 21,

1997, to one count of **misuse of a Social Security number** (SSN). The OIG initiated an investigation based on information provided by the DAO-4, which had received an anonymous complaint that, while employed by SBA, the employee had obtained and subsequently misused the SSN of a loan applicant with the same name. The investigation confirmed that the employee had applied for and received credit and merchandise from four Sacramento-area businesses using the loan applicant's SSN. The stores lost a total of \$6,217 as a result of her activities.

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OIG Management

Semiannual Report to Congress Completed. The OIG has prepared its Semiannual Report to Congress. The report, which covers the period October 1, 1996, to March 31, 1997, reflects \$44,150,901 in dollar accomplishments for the period as follows:

- \$21,251,476 in potential recoveries,
- \$16,545,466 in management avoidances,
- \$1,035,911 in disallowed costs agreed to by SBA management, and
- \$5,318,048 in management commitments to use funds more efficiently.

Moreover, OIG investigations produced 22 indictments and 34 convictions. The report must be transmitted to the

Administrator on April 30; it will be transmitted to the Congress on May 31 and be available to the public shortly after this date.

Editor's Notes:

The following identifies the use of adjectives in this Update 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, James F. Hoobler, Inspector General.

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