



# Office of Inspector General Small Business Administration

February 1998 Update

## *Business Loans*

Audit of SBA Loan Liquidations Finds Inadequate Recoveries and Procedural Problems. An audit of FY 1994 loan liquidations, issued February 27, 1998, found that SBA **should have recovered \$28 million more in loan liquidations than it did.** Auditors found that **liquidation procedures were applied inconsistently**, and SBA did **not effectively monitor lenders nor identify opportunities to recover losses** when lenders did not follow approved procedures.

SBA "charged off" \$345 million in FY 1994 from 3,112 loans liquidated. After examining a statistical sample of 71 liquidations with \$12.5 million charged off, the auditors concluded there were errors in 12 of the 71 liquidations that resulted in \$652,608 under-recovered. Based on the sample, the auditors estimated that \$28 million was under-recovered in the full year.

The audit was inconclusive on whether it was more effective for loans to be liquidated by lenders or by SBA. While lenders had a higher recovery rate, the audit found that their recovery rates could have been even higher. The audit recommended that SBA ensure that SBA

loan officers be made aware of their responsibility for monitoring lender liquidations, and that SBA initiate recovery actions on specific loans where lender deficiencies were identified. The Assistant Administrator for Financial Assistance concurred and noted that revised SOP 50 51 2 emphasized the importance of lender oversight. Other improvements in procedures resulted from the Agency's Liquidation Improvement Project which started in 1996.

New Jersey Restaurant Owner Pleads Guilty to Making False Statements. The owner of a Seaside Heights, New Jersey, restaurant and bar pled guilty on January 27, 1998, to a one-count information that charged him with **making false statements** in applying for, and accounting for the use of proceeds of, a \$616,000 SBA-guaranteed loan to his corporation. In the plea agreement he admitted that, on the Statement of Personal History included with his application, he omitted his arrest and conviction for bribing a public official. He also acknowledged submitting to the participating non-bank lender and SBA altered tax returns and fraudulently endorsed two-party checks. The case, worked jointly with the FBI, was based on information provided by SBA's Newark District Office.

Illinois Machine Manufacturer Sentenced for Making False Statement. The former owner of an industrial machine manufacturing company in Dolton, Illinois, was sentenced on October 14, 1997, to 2 years probation (including 6 months home detention) and \$21,403 restitution to SBA and the participating lender bank. He previously pled guilty to one count of knowingly **making a false statement** to influence SBA. The company was approved in 1992 for a \$325,000 SBA-guaranteed business loan, of which \$42,500 was to be used to purchase machinery and equipment. The owner subsequently submitted an SBA settlement sheet that certified that he already had spent \$38,500 of the loan proceeds to purchase a milling machine and would spend an additional \$4,000 to purchase more machinery. The OIG's investigation documented that his certification was false as he actually spent only \$2,000 on machinery and equipment. The OIG initiated the investigation based on a referral from a liquidation loan officer in SBA's Chicago District Office.

Massachusetts Coffee Wholesaler Charged With Making False Statements. The president of a Quincy, Massachusetts, wholesaler of specialty coffees and related items was charged on February 19, 1998, with five counts of **making false statements on loan applications to a Federally-insured financial institution.** According to the criminal information, he provided false documents and made false statements in obtaining two loans and a credit line from a participating lender bank during 1995. The larger loan, for \$143,000, was guaranteed by SBA. The business owner is charged with falsely claiming that he

had made an equity investment in his business, submitting false documents pertaining to the use of the loan proceeds, and submitting balance sheets containing false financial information about his business. The joint SBA/OIG and FBI investigation originated from a referral to the OIG by SBA's Boston District Office.

Iowa Manufacturer Pleads Guilty to Making False Official Certification. An officer of a manufacturing company in Central City, Iowa, which had produced tent stakes for the Army pled guilty on January 30, 1998, to one count of **making a false official certification**. He was sentenced to pay a \$2,000 fine and on February 18, 1998, he paid a \$25,000 civil settlement. The SBA/OIG's joint investigation with the Defense Criminal Investigative Service found that, to gain approval of the firm's application for a \$500,000 SBA-guaranteed loan to buy the assets of a debarred defense contractor, the businessman submitted a fraudulent certification of his financial condition to the participating lender bank. The information charged that he falsely certified that he had \$175,000 available from personal savings to invest in the firm and failed to disclose outstanding debts, including a significant loan from the owner of the debarred contractor. This investigation was opened based on information developed in an investigation that resulted in the June 1994 conviction of the former owner and an associate for fraud in connection with an SBA certificate of competency.

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## ***Disaster Assistance***

Owner of St. Croix Rental Property Found Guilty of Making False Statements. The owner of rental property in St. Croix, Virgin Islands, was found guilty on February 10, 1998, on two counts of **making false statements** to SBA in applying for a \$23,000 disaster loan for losses to four rental units she owned on St. Croix, U.S. Virgin Islands. The woman, a Decatur, Georgia, school teacher, was convicted for submitting altered "copies" of tax returns for the years 1993-94 following Hurricane Marilyn. Although the tax returns she submitted to SBA reported rental income, she had reported no such income to the IRS. The loan application was declined when SBA's tax verification program detected the discrepancies. The case was based on a referral from SBA's Disaster Assistance Area 1 Office.

California Market Owner Indicted for Making False Statements. The owner of a mini-market in Los Angeles, California, was indicted on February 11, 1998, on one count of **making false statements** to SBA. After the mini-mart was burned down during the 1992 civil unrest, the man had obtained disaster loans totaling \$116,000. With SBA approval, he relocated to Oregon City, Oregon, and opened an Asian-food restaurant. The SBA/OIG's investigation found that, to receive further disbursements of disaster loan funds, he falsely certified that he had spent the previously-disbursed loan funds in accordance with the Loan Authorization and Agreement. He submitted to SBA a Borrower's Progress Certification with an invoice showing purchases exceeding \$94,000 from a restaurant equipment supplier. The investigation found that he only

purchased approximately \$2,000 of items from the supplier and instead used at least \$56,000 of the loan funds as a down payment on a home. The owner subsequently filed bankruptcy, and SBA incurred a loss of approximately \$91,000. The case was referred to the OIG by SBA's Portland District Office.

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## ***Minority Enterprise Development***

Owner of Virginia Section 8(a) Firm Understates Wealth to Gain Minority Set-Aside Contracts. The owner of a Section 8(a) firm in Chantilly, Virginia, was found to have improperly **understated his personal net worth by approximately \$600,000** in an effort to participate in the program. For 2 of the 4 years for which he provided the incorrect financial information, OIG auditors found that his true net worth would have excluded him from participation. Through 1997, the firm had been awarded four Section 8(a) contracts with a total estimated value of \$4.4 million. The audit determined that the firm should not have been eligible for two of those contracts. The OIG recommended that SBA suspend the firm immediately from Section 8(a) program participation and initiate action to terminate the company from the program. SBA program officials concurred in the recommendation.

President of Maryland Section 8(a) Contractor Indicted for Making False Statements and Wire Fraud. The president of a computer and engineering-services contractor in Lanham, Maryland, was indicted on February 13, 1998, on three counts of **making false**

**statements** to SBA and one count of **wire fraud**. The indictment charged that he had submitted a series of false Personal Financial Statements for SBA's 1992-94 annual reviews of his status as a disadvantaged owner of a firm participating in the Section 8(a) program. The man allegedly concealed his true net worth when he failed to disclose that he had, among other assets, ownership interests in two other companies, various pension and retirement accounts, approximately \$500,000 in a Swiss investment account, and approximately \$190,000 in a bank account. He was charged with falsifying his financial statements to hide the fact that his net worth exceeded the Section 8(a) program's limit, making him ineligible for participation in the program. During an SBA/OIG audit of his Section 8(a) eligibility, he voluntarily withdrew his company from the program, through which it had been awarded more than \$10 million in contracts. This investigation, conducted jointly with the OIGs of the Treasury and Transportation Departments and the National Aeronautics and Space Administration, was initiated based on both a referral from SBA's Washington District Office and the SBA/OIG audit.

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### ***Small Business Investment Companies***

Michigan Corporate Officer Sentenced for Misapplying Funds and Failing to File Currency Transaction Report. An officer and director of a specialized small business investment company (SSBIC) in Farmington Hills, Michigan, was sentenced on December 23, 1997, and

was ordered to pay \$325,000 to the Government. He and another company officer had each pled guilty to one count of **misapplying funds of a financial institution** and one count of **failing to file a required Currency Transaction Report**. With regard to the count of "misapplying funds," the two caused the SSBIC to loan money to a business in Michigan which they knew was going to forward the funds to a business in California previously denied a loan by the SSBIC. With regard to the count of "failure to file," the pair, as officers of the SSBIC and a related company, caused the related company to accept, in the regular course of business, \$20,000 in cash. The company failed, however, to file a Currency Transaction Report with the Department of the Treasury. The investigation was conducted jointly by the U.S. Secret Service, the IRS, and the SBA/OIG. It developed from information uncovered in an investigation of another SSBIC. Under the civil forfeiture order, the \$325,000 will go to the IRS and the U.S. Secret Service. SBA will receive none of these proceeds even though more than \$100,000 of the misapplied funds came from the SSBIC. The SBA/OIG continues to seek legislation allowing it to participate in the Government's Asset Forfeiture program.

The SBA, in response to the criminal plea, has entered a stand still agreement with the two individuals who pled guilty. Pursuant to this agreement, the two individuals are suspended from their positions with the SSBIC and have agreed to take no part in the operation of the SSBIC. Additionally, SBA has refused to roll over \$2 million of SBA-owned debentures, issued by the SSBIC, which are due and payable.

*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](http://WWW.SBAONLINE.SBA.GOV/IG/REPORTS.HTML)**

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

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