



Office of Inspector General Small Business Administration

February 2001 Update

Business Loan Programs

Two Californians Plead Guilty to Mail Fraud and Misappropriation of Collateral. Two associates of an equipment manufacturer in San Diego, California, pled guilty on January 17, 2001, to one count of **misappropriation of SBA collateral** and one count of **mail fraud**, respectively. As part of the plea agreements, the Government agreed to dismiss other charges on which they and their codefendant were previously indicted. The company had obtained an \$833,000 Export Working Capital loan in 1996. The line of credit disbursements were to be used to finance production of mining conveyors. The indictment charged that the three defendants submitted false documentation to obtain the SBA-guaranteed loan disbursements, including false invoices and false facsimile transmissions. The defendants also allegedly transferred property of the company to conceal it from the U.S. Bankruptcy Court. The indictment also charged that one of the defendants made material omissions on the company's Statement of Financial Affairs to the U.S. Bankruptcy Court. SBA's net chargeoff on the loan was \$175,051. The company received national recognition as SBA's 1996 Exporter of the Year. OIG joined the Federal Bureau of Investigation (FBI) investigation at the request of the U.S. Attorney's Office for the Southern District of California.

Three Texans Indicted for Conspiracy and Lying. Two principals of a Dallas, Texas, automotive repair and service station and a certified public

accountant (CPA)/SBA loan package preparer were indicted on February 6, 2001, on 1 **conspiracy** count and 25 counts of **making material false statements**. Each was indicted for fraudulently inducing a non-bank participating lender and SBA to fund a \$355,000 SBA-guaranteed loan for the service station. The two principals and the CPA allegedly falsified nine Federal tax returns, six Internal Revenue Service (IRS) tax verifications, two leases containing forged signatures of the fuel company's regional and district managers, and an \$85,000 capital injection. The indictment also charges the three defendants (superseding an earlier indictment of the two principals) in connection with fraudulently inducing a \$200,000 SBA-guaranteed loan to another automotive repair and service station in Dallas. The two principals and the CPA allegedly submitted six falsified copies of Federal tax returns, three fraudulent IRS tax verifications, and numerous other fraudulent documents in support of the second loan and a \$60,000 capital injection into the business. SBA/OIG conducted this investigation, which is continuing, jointly with the Department of Treasury's OIG for Tax Administration.

SBA Office of Capital Access Responds to January Advisory Audit Report. On February 12, 2001, the Office of Capital Access (OCA) responded to OIG's January 10, 2001, advisory audit report that identified possible ineligible borrowers within the Section 7(a) Business Loan program. OCA's response advised of actions being taken to address OIG recommendations. While conducting an audit of the Preferred Lender Program Oversight

Process, OIG identified a principal with three current loans who had caused SBA a loss on a prior loan. A subsequent query of the SBA loan accounting system using the Social Security numbers (SSN) of principals showed that this was not a unique situation.

OIG found 180 loans made during fiscal years 1998, 1999, and 2000 whose principals had previously defaulted on SBA loans. Of the 180 loans, 31 were loan commitments valued at about \$12.5 million. Because the SSNs for the principals of the committed and defaulted loans were the same, it appears that the loans may have been inappropriately approved. These commitments involved the Fastrack, Section 504, International Trade, and General Business Loan programs using the preferred, express, and regular loan processing procedures.

OIG recommended that OCA suspend loan disbursement until a determination is made that the principals are the same, that they declared the prior default, and that a waiver was granted. In the event a waiver was not granted, OIG recommended the loan commitment be cancelled. OCA concurred with our recommendations. Additional audit work will be done later this fiscal year to address the remaining 149 loans.

Disaster Loan Program

Mississippi Assistant Minister Pleads Guilty to Lying. The assistant minister of a Gulfport, Mississippi, church entered into a memorandum of understanding (MOU) on November 27, 2000, to plead guilty to a one-count information for **making a material false statement** to SBA. The U.S. District Court for the Southern District of Mississippi accepted the terms of the MOU on January 31, 2001. The church had received a \$257,600 disaster loan to repair physical damage caused by Hurricane Georges. The assistant minister's guilty plea involved his misappropriation of \$75,000 of the loan proceeds. He submitted numerous false invoices to SBA in support of his request for loan disbursements.

Audit Issued on Disaster Assistance Program's Implementation of Performance Measurement

Requirements. On February 15, 2001, OIG issued an audit report on the Disaster Assistance program's implementation of performance measurement requirements of the Government Performance Results Act of 1993 (Results Act). The audit found that SBA had not fully implemented the performance measurement requirements of the Results Act for the Disaster Assistance program. Specifically, the program did not have performance indicators to determine the extent to which it accomplished its mission under the Small Business Act. Furthermore, disaster home loan currency and delinquency rates were misleading since they excluded a large portion of disaster loans and the indicator for effective field presence was not consistently applied. As a result, program officials could not measure the extent the program helped businesses and families recover from disasters, and whether the products and services were cost-effectively delivered.

OIG recommended that the Office of Disaster Assistance: (1) develop an outcome indicator to measure results aligned with the statutory mission, (2) develop an indicator to gauge program delivery costs, and (3) consistently report disaster field staff presence. In addition, we recommended that the Office of Financial Assistance revise the disaster loan currency/delinquency performance indicator.

SBA management officials concurred with three of our recommendations. Their response included both short-term and long-term plans to implement the recommendations. The action SBA management proposed for the last recommendation was not fully responsive. OIG has outlined the actions SBA needs to take before this recommendation is considered resolved.

Surety Bond Guarantees

Audit Issued of Surety Company. In an audit report issued February 22, 2001, of a surety bond company, OIG found that surety fees were correctly calculated, but not always submitted to SBA in a timely manner. The audit also found that the surety did not always comply with SBA regulations for underwriting and servicing bonds. More specifically, the surety did not obtain status reports for three bonds and maintain complete underwriting documentation for another bond. As a result,

OIG recommended that the surety implement policies and procedures to correct these problems and remit \$709 in unpaid surety fees. The Office of Surety Guarantees agreed with OIG's recommendations.

Government Contracting and Business Development

Pennsylvania Construction Company President Pleads Guilty to Mail Fraud and Lying. The president of a defunct construction company in Huntingdon Valley, Pennsylvania, pled guilty on February 5, 2001, to one count of **mail fraud** and one count of **making a material false statement**. The false statement count related to the man's representation that he was the 100 percent owner of the construction company on his SBA Form 1010B, the Section 8(a) program application. In a deposition, however, the man testified that he owned only 40 percent of the company. The other count related to falsely reported payments to subcontractors and false progress payment certifications on a \$1.6 million contract for renovations at a Philadelphia-area college library. A principal condition of the plea agreement is that the defendant will make restitution (pursuant to a stipulated \$3.2 million judgment) to his surety-bonding company before he is sentenced. SBA/OIG is conducting this investigation jointly with the Naval Criminal Investigative Service (NCIS) and the Department of Veterans Affairs' (VA) OIG.

Pennsylvania Construction Company Pleads Guilty to Conspiracy to Defraud Government, Filing False Claims, and Major Fraud Against United States. A defunct Philadelphia, Pennsylvania, construction company that had participated in the Section 8(a) program pled guilty (through its president and vice president) on February 16, 2001, to all 14 counts on which it had been indicted. These included 1 count of **conspiracy to defraud the Government**, 12 counts of **filing false claims**, and 1 count of **major fraud against the United States** in connection with alleged schemes to defraud SBA, the Department of the Navy, and the Department of Agriculture (USDA). The counts related to falsely reported payments to subcontractors and false progress payment certifications. The corporation's sentencing date has not

been set yet. As to the corporation's codefendants, the president pled guilty in July 2000 to all 15 counts on which he had been indicted; the vice president's trial on the 16 counts on which he had been indicted began on February 20, 2001. SBA/OIG joined NCIS, the Army Criminal Investigation Command (Army CID), the Defense Criminal Investigative Service (DCIS), USDA/OIG, and the Department of Labor's OIG in the investigation based on a referral from NCIS.

New Jersey Construction Company and President Plead Guilty to Major Fraud Against United States and Lying. A Newark, New Jersey, general construction company and its president pled guilty on February 16, 2001, to District of New Jersey informations charging them with fraudulently obtaining more than \$8 million in Section 8(a) contracts. On the same day, the president pled guilty to a Southern District of New York information charging him with fraudulently obtaining more than \$3 million in minority business enterprise preference contracts from the Port Authority of New York and New Jersey. The New Jersey informations charged the company and its president each with one count of **major fraud against the United States** and two counts of **making material false statements**; the Southern New York information charged the president with three counts of **mail fraud**. In October 1993, the president had submitted a Section 8(a) program application to SBA. The application included resumes for individuals purported to be key employees of the company, documents purported to be corporate minutes of the company containing signatures of officers, and other false documents claiming to identify employees and equipment of the company. In August 1994, he also submitted a Section 8(a) business plan in which he represented that the company was equipped to handle construction work in 26 different specialties. In pleading guilty, however, the president admitted that the company was really a storefront operation run out of an apartment in Newark. He explained that the company never had the employees, equipment, or experience necessary to be a viable construction company. Based on the false statements, SBA admitted the company into the Section 8(a) program and assisted it in obtaining contracts. Because the company in fact lacked the ability to perform the work, its president brokered

the contracts to nonminority-owned companies in return for a percentage of the contract value. From December 1995 to June 1996, he kept a progressively larger portion of the contract payments for himself, including amounts owed to the nonminority-owned companies he hired to perform the actual work. As the president fell further behind in paying these companies, some ceased work on the contracts and abandoned the job sites. Eventually, the company defaulted on four of its seven Section 8(a) contracts, causing a loss of approximately \$800,000 on one contract alone. SBA/OIG initiated its case based upon a referral from Army CID and investigated it jointly with that agency and DCIS, NCIS, VA/OIG, and the Postal Service's OIG.

Small Business Investment Company Program

New York Small Business Investment Company President Pleads Guilty to Embezzling and Misapplying Funds. The president of a New York small business investment company (SBIC) pled guilty on February 20, 2001, to an information charging him with **embezzling and misapplying funds** belonging to the SBIC. From October 1987 through November 1994, the president had caused the SBIC to overpay, to the advantage of two private companies affiliated with him, approximately \$71,176 more than its rightful rent obligations at the site they jointly occupied. The president's actions delayed SBA's seizure of control of the SBIC and significantly contributed to the Agency's loss, which exceeded \$2,229,000. This investigation, conducted jointly with FBI, originated from a referral from SBA's Office of General Counsel.

Employee Conduct

Former SBA District Director Sentenced for Crimes as Banker. A former SBA district director (DD) who later headed the SBA division of a participating lender bank in Paramount, California, was sentenced on February 5, 2001, to serve 15 months incarceration and 5 years supervised release and ordered to pay \$6,000 restitution. He previously pled guilty to one count each of **accepting a gift for procuring a loan** and **fraud-**

lently receiving money from a loan transaction.

The allegations date back to 1990 and 1992 actions at the bank that the former DD joined after leaving SBA in 1984. He admitted that he corruptly accepted a \$24,000 automobile from a loan brokerage as a reward for its business with the bank. He also admitted that, in his official capacity at the bank, he received money both directly and indirectly from the proceeds of a \$1 million SBA-guaranteed loan made to the brokerage head to purchase a gas station and mini-mart business. The former DD failed to disclose either that he owned 50 percent of the business or that he was going to receive at least \$65,000 of the loan proceeds for his personal use. According to his plea agreement, from 1989 through 1992, he received approximately \$2 million in incentive bonuses and commissions from the bank's secondary-market sale of SBA-guaranteed loans plus a base salary that eventually reached \$250,000.

OIG's investigation of the former DD and the brokerage firm's connection to the failure of the bank has been conducted jointly with FBI. During his years at the bank, at least 17 borrowers submitted fraudulent documents, including falsified "copies" of tax returns, seeking SBA-guaranteed loans. Besides the former DD, 18 individuals have been charged to date in the case and an additional 6 in the case of another loan broker with whom he did business. Twenty-one of the 24 have pled guilty, 1 was acquitted, and the trial of the other 2 is pending. OIG initiated the investigation based on allegations from an anonymous complainant.

Agency Management

Advisory Memorandum on SBA's Loan Monitoring System Issued. As part of an ongoing evaluation of the development of SBA's Loan Monitoring System (LMS), OIG issued an advisory memorandum report February 23, 2001. This is the first of a series of reports OIG plans to issue as project milestones are reached or significant concerns arise. The report addresses the need to: (1) update the LMS Project Plan, (2) expand the LMS Security Risk Assessment as systems assets are defined, (3) document and distribute project status reports and the results of meetings and reviews, (4) strengthen the quality assurance function, and (5) strengthen acquisition planning.

The Chief Operating Officer agreed with OIG's recommendations.

SBA's FY 2000 Financial Statements Receive Unqualified Opinion for Fifth Consecutive Year.

SBA's FY 2000 financial statements received an unqualified opinion for the fifth consecutive year. The opinion also noted that there were no material weaknesses this year, and the SBA is in substantial compliance with the Federal Financial Management Improvement Act. The opinion was issued in an audit report dated February 28, 2001. The independent auditors determined that the financial statements presented fairly, in all material aspects, the financial position of SBA as of September 30, 1999, and 2000, and its net costs, changes in net position, budgetary resources, and financing for the years then ended were in conformity with generally accepted accounting principles.

The independent auditors also determined that there were two reportable conditions involving SBA's internal control and its operation that were not material weaknesses. This is the first time that the independent auditors did not find any material weaknesses in SBA's internal control and operation. More specifically the independent auditors reported that: (1) SBA's financial reporting processes and procedures were not adequately documented and a fully effective quality assurance process was not in place, and (2) SBA's security-monitoring program was not fully implemented. Recommendations were made by the independent auditors to correct these reportable conditions. In its response to the audit findings, the Chief Financial Officer stated that SBA is working to eliminate the reportable conditions. The reportable condition involving the security-monitoring program will be addressed in detail in a separate and subsequent report titled Audit of SBA's Information Systems Controls-FY 2000.

Office of Inspector General

OIG has established an e-mail address (oig@sba.gov) that we encourage the public to use to communicate with our office. We welcome your comments on our publications, 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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