Office of Inspector General
U.S. Small Business Administration

November 2007 Update

## *Business Loan Programs*

Ongoing Investigation Results in Indictment and Sentencing. In January 2007, arrest warrants were issued for 19 individuals sought in connection with a scheme in which a lender's former executive vice president and others, not employed by the lender, conspired to fraudulently qualify loan applicants for SBA-guaranteed loans. The scheme involved at least 76 fraudulent loans totaling over $76 million. So far the investigation has resulted in the indictment of 30 individuals, three of whom are currently international fugitives. In addition, as a result of this investigation, the lender began to repay the SBA its guaranties for certain loans and cancel the guaranties on others. To date, SBA recoveries from the lender, together with potential cost savings from the withdrawal of the SBA guaranties, have totaled approximately $16 million.

This criminal investigation is continuing, with further indictments expected. The following two cases are part of the ongoing investigation, which is being conducted jointly with the U.S. Secret Service (USSS).

- Michigan Man Named in Federal Indictment. On November 27, 2007, a Michigan man was named in a 21-count federal indictment charging him with conspiracy to defraud the government, false statements, bank fraud, counterfeiting securities, and possession of an implement particularly suited for making a counterfeit and forged security. On November 28, 2007, special agents of the OIG and the USSS arrested him at his home without incident. According to the indictment, he conspired with others to defraud the government in connection with 19 SBA-guaranteed loans made by a Troy, Michigan lender and 1 SBA-guaranteed loan made by a Knoxville, Tennessee lender. The Michigan lender's loans totaled about $10.5 million, and the Tennessee lender's loan was for $2 million. Most of these loans have since gone into default.

  The indictment alleges that the Michigan man's co-conspirators fraudulently obtained SBA-guaranteed loans for the purchase of gas stations, oil change businesses, restaurants, and a laundromat. He is alleged to have supplied his co-conspirators with counterfeit bank statements and counterfeit bank account verification letters falsely documenting non-existent assets in order to make the applicants appear more creditworthy. It is also alleged that he supplied his co-conspirators with counterfeit and forged official bank checks, which were used by the co-conspirators to falsely document the borrower equity injections required by the terms of these loans.

- Former Gas Station Manager Sentenced. On November 15, 2007, the former manager of a gas station and convenience store in Michigan was sentenced to 30 months in prison followed by 36 months of supervised release. He was further sentenced to pay $868,455.82 in restitution to an SBA lender. The former manager, along with the president of the gas station, were previously indicted for conspiracy and multiple counts of making false statements in connection with a $944,000 loan to the president of the gas station. The investigation determined that they conspired with others to fraudulently obtain the loan, with the gas station president serving as a "straw buyer." The fraud involved numerous false equity injection documents, including a phony gift affidavit signed by the former gas station manager. The business failed within months and SBA purchased its guaranty in the amount of $709,264. The lender subsequently repaid the guaranty to SBA.

Investment and Loan Corporation Owner Indicted. On November 1, 2007, the owner/president of an investment and loan corporation was indicted in the Northern District of Illinois. He was charged with four counts of wire fraud in connection with schemes to defraud the SBA and a preferred lender. The indictment also charged three other individuals with two counts each of wire fraud for their participation in the schemes.

The schemes involve two SBA-guaranteed loans: one for $1,333,000 for the purchase of a hotel property and one for $1,240,000 for the purchase of a gasoline station. As detailed in the indictment, the owner's primary activities at the investment and loan corporation involved brokering the sales of gas stations and hotels in the Midwest, and obtaining financing for the new owners. In this process, he assisted buyers with the preparation and submission of loan applications, which included documents showing the source of the applicants' equity injections. The indictment alleges that he used bank statements from his own accounts to create counterfeit statements showing that his clients possessed adequate cash funds for their required equity injections. The other three participants are alleged to have applied for and received loans that they knew they were not qualified to receive. The indictment also contains forfeiture allegations exposing the assets of the referenced defendants to forfeiture, including but not limited to the $2,573,000 in loan proceeds. This ongoing investigation has revealed a broad pattern of fraud within the transactions brokered by this investment and loan corporation.

Former Escrow Officer Sentenced. On November 30, 2007, a former escrow officer for a Texas title company was sentenced to 96 months in prison followed by five years of supervised release. She was previously convicted of one count of conspiracy, one count of conspiracy to commit money laundering, one count of bank fraud, and four counts of money laundering. The charges arose from her involvement in a multi-million dollar scheme to defraud the SBA and launder hundreds of thousands of dollars in loan proceeds. Evidence presented during the trial established that she and other co-conspirators devised a fraudulent land flip scheme to obtain an SBA-guaranteed loan in the amount of $2.4 million from a federally insured bank to fund the purchase of a warehouse. Once the loan was funded, she and her co-conspirators laundered approximately $473,000 of the proceeds. The OIG conducted this joint investigation with the Texas Comptroller of Public Accounts, Criminal Investigation Division.

## *Disaster Loan Program*

Florida Couple Sentenced. On November 1, 2007, a Florida couple was sentenced in U.S. District Court for the Southern District of Mississippi. The wife was sentenced to 36 months probation and a $500 fine. The husband was sentenced to 18 months in prison, 36 months probation, and a $4,000 fine. He was also ordered to pay $6,706 in restitution to the Federal Emergency Management Agency (FEMA). Both subjects were ordered to jointly pay restitution of $47,078.28 to SBA. The sentencing resulted from the couple providing false statements in an attempt to receive Gulf Coast Hurricane benefits to which they were not entitled. Based on the false statements on their loan application and during the loss verification inspection, the couple received $50,000 of the approved $112,500 loan from SBA. The couple stated that their primary residence was in Mississippi, when in fact they lived in Florida and were not affected by any of the hurricanes. The couple also received $6,706 from FEMA. The OIG is conducting this joint investigation with the Federal Bureau of Investigation (FBI) and the Mississippi State Auditor's Office.

Louisiana Business Owner Indicted. On November 15, 2007, a Louisiana business owner was indicted on one count of obstruction of justice and one count of making false statements to federal agents. The business owner allegedly conspired with a Certified Public Accountant (CPA) to fraudulently obtain SBA disaster loans totaling approximately $3 million. Due to investigative efforts, only $5,000 of the $3 million was disbursed. The indictment charges him with destroying and mutilating a forged SBA financial document in order to impede the criminal investigation, and with making false material statements to representatives of the OIG and USSS. The OIG is conducting this joint investigation with the USSS.

## *Entrepreneurial Development*

OIG Issues Report on Grant Disbursements to Women's Business Centers. On November 20, 2007, the OIG issued an Audit of Grant Disbursements to Women's Business Centers. The objectives of the audit were to determine the extent of delays in the disbursement of grants to WBCs and to identify improvements needed to expedite disbursements. The auditors also conducted a brief review of the WBC grant award process to identify opportunities to streamline grant awards. The audit determined that only about 25 percent of WBC payment requests, involving both regular and sustainability grants, were disbursed within the Office of Management and Budget's (OMB) goal of 30 days from receipt of the payment request. The audit found that the delays in grant disbursements occurred because:

- SBA interpretations of payment requirements sometimes changed and were not properly communicated to WBCs, resulting in inaccurate or incomplete submissions by WBCs.
- Payment requests were rejected before both the Office of Management and Administration and the Office of Entrepreneurial Development had performed complete reviews of the submissions, causing WBCs to submit their paperwork multiple times and triggering restarts of the Agency's payment approval process.
- When payment requests were rejected, the entire original package and corrected versions were mailed back and forth between SBA and the WBCs, instead of only correcting the document(s) affected.
- The Agency lacked an integrated tracking mechanism to identify when a payment request was received, where it was in the review process, and whether a disbursement had been made within OMB's 30-day requirement.

The OIG made seven recommendations to the Associate Administrator for Entrepreneurial Development to work collaboratively with the Office of Management and Administration to make the WBC payment request process more efficient and transparent. In addition, opportunities to streamline SBA's process for awarding WBC grants were noted. These involved improving the timeliness of grant opportunity announcements and processing awards for established WBCs at the same time as new entrants. The OIG made three recommendations to the Associate Administrator for Entrepreneurial Development to improve the process for awarding grants. The Offices of Entrepreneurial Development and Management and Administration generally agreeing with the findings and recommendations.

## *Agency Management*

Audit of SBA's FY 2007 Financial Statements. On November 15, 2007, pursuant to the Chief Financial Officers Act of 1990, the Independent Auditors' report and accompanying reports on internal control and compliance with laws and regulations were issued by KPMG LLP for the fiscal year ended September 30, 2007. The audit was performed under a contract with the OIG and in accordance with Generally Accepted Government Auditing Standards; OMB Bulletin 07-04, Audit Requirements for Federal Financial Statements, the Government Accountability Office (GAO)/President's Council on Integrity and Efficiency (PCIE) Financial Audit Manual and GAO's Federal Information System Controls Audit Manual.

The KPMG report concluded that SBA's consolidated financial statements presented fairly, in all material respects, the financial position of SBA as of and for the years ended September 30, 2007 and 2006. They also presented fairly, in all material respects, SBA's net costs, changes in net position, and combined statements of budgetary resources for the years then ended. With respect to internal control over financial reporting, KPMG reported a significant deficiency related to Information Technology security controls, but did not consider this deficiency to be a material weakness. KPMG's test for compliance with certain laws, regulations, contracts, and grant agreements determined that the Agency did not fully comply with the Debt Collection Improvement Act (DCIA) of 1996 because SBA did not consistently follow Treasury guidelines when referring delinquent debts for collection. The auditors did not report any other instances or matters regarding noncompliance.

SBA's Chief Financial Officer (CFO) concurred with the Independent Auditor's findings and agreed to implement the recommendations. She also acknowledged that SBA was not in compliance with the DCIA and outlined Agency plans to improve standard operating procedures.

OIG Issues Report on SBA's FY 2008 Management Challenges. In accordance with the Reports Consolidation Act of 2000, the OIG issued its Report on the Most Serious Management and Performance Challenges Facing SBA in FY 2008. This report provided the OIG's current assessment of Agency programs or activities that pose significant risks, including those that are particularly vulnerable to fraud, waste, error, mismanagement, or inefficiencies. The Agency continued to demonstrate substantial progress in resolving the Challenges. For example, as a result of SBA's efforts to identify and address the underlying causes of its financial management issues, improve the models for estimating the Agency's subsidy costs, strengthen controls over financial statement preparation, and adhere to all reporting deadlines, the FY 2008 report reflected the elimination of one Challenge from the previous year: "SBA faces significant challenges in financial management and reporting, which affects its ability to provide reliable, timely, and accurate financial information" (formerly Challenge 2). The report is available on the OIG's website at: http://www.sba.gov/ig/FY2008_Challenges.pdf.

## Other

OIG Issues Fall 2007 Semiannual Report to Congress. The OIG issued its Fall 2007 Semiannual Report to Congress. The report summarized the results of the OIG's investigations, audits, and other activities during the period April 1, 2007 through September 30, 2007. During this six month period, the OIG issued 15 reports with significant recommendations for improving Agency operations, reducing fraud and unnecessary losses, and recovering funds. OIG investigations led to 53 indictments and 42 convictions of subjects who defrauded the Federal Government. In addition, the OIG collectively reviewed 77 legislative, regulatory, policy, procedural, and other proposals concerning the SBA and Government-wide programs. With a staff of approximately 100, the OIG continued to produce substantial savings and important program improvements. The report is available on the OIG's website at: http://www.sba.gov/ig/Fall%202007%20SAR%2011-30-07.pdf.

## Statutory/Regulatory/Policy Reviews

In an effort to proactively identify and correct potential Agency inefficiency and management problems at the onset of policy and regulatory development, the OIG reviewed, cleared, and/or provided comments, as appropriate, on 9 Agency initiatives, including proposed legislation, SBA Standard Operating Procedures, and Agency notices containing directives to its employees.

This monthly update is produced by the SBA OIG, Eric M. Thorson, Inspector General.

The 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 concerning this update or other OIG publications. To obtain copies of these documents please contact:

Beverly Menier, SBA OIG
409 Third Street SW., 7th Floor
Washington, DC 20416
E-mail: OIG@SBA.GOV
Telephone number (202) 205-6586
FAX number (202) 205-7382

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