



Office of Inspector General Small Business Administration

February 1997 Update

Business Loans

Ohio Medical Equipment Manufacturer Sentenced for Bank Fraud. The president of a Chardon, Ohio, manufacturer of medical equipment was sentenced on December 30, 1996, to 5 months imprisonment, 5 months home confinement with electronic monitoring, 5 years supervised release, and \$75,000 restitution, of which 82 percent goes to SBA. He had previously pled guilty to one count of **bank fraud**.

The OIG's investigation revealed that at the time the company's president was negotiating to obtain a \$700,000 SBA-guaranteed loan, and during the subsequent loan disbursement period, he concealed from SBA and the participating lender bank his intent to sell a substantial portion of the business assets. He also diverted a majority of the proceeds from those sales to pay off other debts. During a May 1996 interview by an OIG special agent, he made material false statements by stating that officials of the participating lender had approved his sale of assets. This investigation was initiated based on a referral from SBA's Cleveland District Office.

Connecticut Businessmen Sentenced for Bank Fraud and Accessory-After-the-Fact. Two brothers--officers of a

Chester, Connecticut, manufacturer of wire products--were sentenced on February 13, 1997. One brother, who had been convicted on one count of **bank fraud** for submitting false information while applying for a \$300,000 SBA-guaranteed loan, was sentenced to 30 months imprisonment and \$450,000 restitution. The second brother, who had pled guilty to one count of being an **accessory-after-the-fact** to one of his brother's false statements, was sentenced to 1 year probation. In applying for the loan, the first brother did not disclose the existence of previous loans and fraudulently offered certain unavailable items of machinery and equipment as collateral. The joint OIG/FBI investigation was based on a referral from SBA's Hartford District Office.

Investigation Finds that New York City Bank Improperly Administered SBA-Guaranteed Loans. An Argentine bank which was once one of SBA's largest participating lenders in New York City paid \$1,260,033 to the U.S. Treasury on December 23, 1996, to settle civil claims for **improperly administering loan s** guaranteed by SBA. The OIG investigation found that bank officers (1) demanded and obtained from borrowers compensating balances to offset the non-guaranteed portion of loans, (2) failed to

disburse loan proceeds in accordance with the bank's agreements with SBA, (3) recovered repayments on a loan without sharing such proceeds proportionately with SBA, and (4) solicited illegal "commissions" in connection with certain SBA-guaranteed loans. In addition to the \$1,260,033 payment, which comprised both reimbursement of amounts the SBA had paid to the bank earlier on six loan guaranties and resulting penalties, the bank has released SBA from liability on its guaranties of 22 other loans totaling \$4,423,668. In an earlier result of the investigation, a former bank vice president was sentenced to 18 months imprisonment for soliciting the illegal commissions.

California Tax Preparer Pleads Guilty to Aiding and Abetting the Making of False Statements. A tax preparer in Los Angeles, California, pled guilty on February 18, 1997, to aiding and abetting the **making of false statements in a loan application to a Federally-insured bank**. Altered copies of income tax returns were submitted in support of a \$265,000 loan application by the owner of a Pomona, California, restaurant. By overstating its business income, the tax preparer created the impression that the applicant had adequate repayment ability and was creditworthy. The altered tax returns were discovered during the investigation of the restaurant owner who became a target of the SBA/OIG's and Secret Service's joint investigation into loans submitted by unscrupulous loan brokers. The investigation into the restaurant owner's activities revealed several more individuals for whom the tax preparer prepared altered income tax returns.

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Disaster Assistance

California Television Repair Shop Owner Indicted for Making False Statements. The former owner of a television repair shop in Los Angeles, California, was indicted on February 4, 1997, on two counts of **making false statements** to SBA. The SBA/OIG initiated the investigation based on a referral from the Liquidation Division of SBA's Los Angeles District Office and worked the case with the Social Security Administration/OIG and the U.S. Secret Service. The subject of the investigation had filed for bankruptcy under several Social Security numbers and concealed his bankruptcy filings from SBA to obtain two disaster business loans following the 1992 civil unrest. He also submitted altered copies of income tax returns when applying for a \$26,400 physical damage loan and a \$13,300 economic injury loan.

California Loan Packager Investigation Continues to Yield Results. These two cases involve applications for disaster loans filed in the wake of the 1992 civil unrest in Los Angeles, California.

- ❶ The owner of a Los Angeles, California, clothing manufacturer was sentenced on February 6, 1997, to 4 months home detention, 3 years probation, and 100 hours community service. She had pled guilty to one count of **filing a false claim** with SBA, i.e., submission of fictitious income tax returns for 1990-91 supporting her

application for a \$300,000 economic injury loan. Based on the financial information in those returns, SBA disbursed \$61,500. She failed to make a single payment on this loan.

② The owner of a liquor store in Los Angeles, California, pled guilty on February 10, 1997, to one count of **making false statements in a loan application to a Federally-insured bank** and one count of **making a false statement to SBA**. In March 1991, the man submitted altered copies of 1987-90 income tax returns to a participating lender bank to obtain a \$631,500 SBA-guaranteed business loan. Similarly, in January 1993, he submitted altered copies of tax returns for 1989-91 to SBA to obtain disaster assistance. He ultimately obtained both a \$71,800 physical disaster loan and a \$59,200 economic injury disaster loan. The investigation subsequently expanded into his acquisition of additional fraudulently-obtained bank loans totaling \$1,193,750. The store owner's loans resulted in lender losses of \$1,097,388 after he filed for bankruptcy and the existing collateral was sold.

These actions resulted from an ongoing, joint OIG/Secret Service investigation of falsified loan applications prepared by the two southern California disaster loan packagers. The case was opened as a result of a tip from a concerned citizen and a referral from SBA's Disaster Assistance Area 4 Office.

Mississippi Businessmen Sentenced for Conspiracy and Making False Statements. The proprietor of a timber company in Hattiesburg, Mississippi, and his attorney were sentenced on January 23, 1997. Each was ordered to pay \$3,600 restitution and a \$150 special assessment. In addition, the owner was sentenced to 18 months imprisonment and 2 years supervised release, and the attorney received a sentence of 4 months home confinement and 2 years probation. The attorney had pled guilty to making material **false statements** to influence SBA, and the owner had been convicted on one count of **conspiracy** and two counts of making material **false statements** to influence SBA.

At the sentencing hearing, the judge set aside (for insufficiency of evidence) the conviction of the owner's wife who had been found guilty on one count of making material **false statements** to influence SBA. All the charges relate to a \$222,400 economic injury disaster loan the owner received in 1993. The OIG initiated the investigation based on a referral from SBA's Gulfport Branch Office.

North Carolina Disaster Home Loan Borrower Indicted for Making False Statements. A Waynesville, North Carolina, disaster home loan borrower was indicted on February 3, 1997, on two counts of **making material false statements** that led SBA to disburse a \$38,400 disaster home loan. She submitted to SBA's Disaster Assistance Area 2 Office allegedly falsified documentation of her use of the loan proceeds, including a mobile home certificate of title, a purchase order, a

certification of hazard insurance, a deed of separation, and a title insurance policy. Subsequently, the woman also submitted allegedly false documents, including 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.

California Food Market Owner Pleads Guilty to Filing a False Claim. The owner of a Reseda, California, food market pled guilty on January 13, 1997, to one count of **filing a false claim** with SBA. The OIG's investigation, opened in response to a referral from SBA's Disaster Assistance Area 4 Office, revealed that the applicant falsely claimed that his business suffered \$180,000 in physical damage and \$260,000 in economic injury following the Northridge earthquake. In fact, the market permanently closed nearly 4 months before the earthquake, and all invoices submitted by the applicant to support disbursement of loan proceeds were false.

Alabama Businessman Pleads Guilty to Mail Fraud. The owner of a real estate company in Enterprise, Alabama, pled guilty on February 25, 1997, to one count of **mail fraud** in an effort to obtain a \$186,800 SBA business physical disaster loan. In return, the U.S. Attorney agreed to dismissal of the other 11 counts on which he had been indicted and 1 count on which his codefendant had been indicted. The OIG's investigation determined that, following a 1990 flood, the real estate company owner applied for the loan and fraudulently listed damaged properties that he did not own. While misusing the loan proceeds, he

mailed claims and receipts showing that these properties were repaired or replaced. His accomplice's part in the scheme involved falsifying repair receipts, which precipitated SBA's ordering of a \$12,800 joint payee Treasury check, and endorsing the check. The co-payee, however, never received any of the proceeds. The investigation was based on a referral from SBA's Birmingham District Office.

California Disaster Loan Recipient Pleads Guilty to Making a False Statement. A Northridge, California, disaster loan recipient pled guilty on February 6, 1997, to one count of **making a false statement** to SBA. He was approved for a \$123,100 disaster home loan following the 1994 earthquake. After having received \$38,900 in proceeds, the man submitted a series of letters requesting (unsuccessfully) that SBA reduce his monthly payments due to a new \$20,000 installment debt incurred for the purchase of a 1994 Acura automobile. The OIG's investigation revealed, however, that he had paid cash for the vehicle. The man learned of the investigation in September 1996 and immediately repaid the \$39,000 balance of his SBA loan. The OIG initiated its investigation at the request of the U.S. Attorney's Office for the Central District of California.

California Developer Pleads Guilty to Filing a False Claim. An owner of a Monterey Park, California, land development company pled guilty on October 20, 1996, to one count of **filing a false claim** with SBA. The principal applied for a \$300,000 economic injury disaster loan following the 1992 Los Angeles civil unrest. The OIG investigation disclosed that the

application package, prepared with the assistance of his former business partner, included copies of fictitious individual income tax returns, as well as an altered copy of the 1991 corporate income tax return. Relying on these documents, SBA approved and disbursed a \$109,300 loan that ultimately went into default without a single payment having been made. The former business partner also pled guilty to a criminal charge resulting from this investigation, which was based on information provided by the OIG's Auditing Division.

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Small Business Development Centers

Audit of Maryland Small Business Development Center Identifies Erroneous Claims. An audit of the Maryland Small Business Development Center identified \$529,000 of **claimed costs that were unallowable** under program guidelines. These included the salary of a non-SBDC employee, paid leave for employees not entitled to the benefit, unrelated travel, improper procurement, and excessive indirect cost. The SBDC's sponsor, the Maryland Department of Business and Economic Development, acknowledged \$152,000 in erroneous claims during the audit. After netting the remainder of questioned costs against cash match requirements, the audit report said the SBDC should reimburse SBA \$125,000.

Problems in counseling services for small businesses were also noted in the audit report. SBDC counselors at one subcenter spent an unreasonable amount of time on administrative functions and

failed to document the delivery of counseling services. While the sponsor disputed some of the findings, SBA's Baltimore District Director concurred in all the audit's findings and recommendations.

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Surety Bond Guarantees

Audit of a Maryland Surety Uncovers Bonds Improperly Underwritten. An audit of a preferred surety company in Maryland (a company that can underwrite SBA-guaranteed bonds without prior approval of SBA) found that **SBA guarantees were issued inappropriately** in 10 of 50 bonds examined in the audit. As a result, SBA provided \$5.3 million in guarantees that should not have been made. The bonds were inappropriate due to of contract splitting and because some projects had already started. Splitting a contract into two or more contracts to avoid the \$1,250,000 limit on SBA-bonded projects is a violation of the regulations. Bonding a project after it has started is also a violation of regulations, unless SBA waives the requirement in writing.

Nine of the 10 bonds cited in the audit involved contract splitting; six were issued after the project started and without SBA approval. The OIG recommended that SBA deny liability on bonds involving contract splitting or untimely approvals and remind the company of the regulations. The Associate Administrator for Surety Guarantees agreed with the recommendations and instructed the surety to remove improperly written

bonds from SBA's database. The Office of Surety Guarantees also sent out a notice to all participating sureties reminding them of the rules governing contract limits, timeliness, and issuing bonds after work has been started.

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Agency Management and Financial Activities

SBA's Annual Chief Financial Officers Act Audit Results in Unqualified Opinion.

For the first time in six years of audits under the Chief Financial Officers Act, **the SBA financial statements for F Y 1996 received an unqualified opinion.** The unqualified opinion means that the independent auditors, Cotton & Company (Cotton), found SBA's principal financial statements to be presented fairly in all material respects in accordance with Office of Management and Budget guidelines and SBA accounting policies. The results of the audit were transmitted to the Chief Financial Officer by the Inspector General, which contracted with Cotton to perform the independent audit.

Cotton found that SBA had made progress on the two problems that had caused the 1995 opinion to be qualified: (1) reconciliation of fund balances with Treasury and (2) inventory of foreclosed properties. These two problems were still identified as "reportable conditions" in the internal control structure, and the cash reconciliation remained classified as a material control weakness.

Four other internal control weaknesses were reported: (1) inconsistent valuation of foreclosed property, (2) lack of annual

estimates of credit reform subsidy rates for disaster loans, (3) computer user password security procedures, and (4) year-end cut-off procedures. In the section on compliance with laws and regulations, the auditors found SBA complied in all material respects with provisions of applicable laws and regulations tested.

Investigation Prompts SBA to Establish Sole-Source Review Process.

As a result of an OIG investigation into possible **improprieties regarding the award of a sole-source contract**, SBA established a board to review all proposed sole-source contracts for more than \$25,000. The investigation had disclosed several irregularities with how SBA awarded a \$150,000 consulting contract. The OIG opened the investigation in response to a request from SBA management.

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The Activity Update is produced by the SBA/OIG, James F. Hoobler, Inspector General.

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