Office of Inspector General
U.S. Small Business Administration

July 2008 Update

Disaster Loan Program

OIG Issues Report on Disaster Loan File Transfer and Servicing Delays. On July 18, 2008, the OIG issued a report that summarized significant risks identified during an ongoing audit of Early-Defaulted Gulf Coast Hurricane Disaster Loans. The audit was initiated in response to the increasing number of defaulted Gulf Coast disaster loans processed by SBA to determine whether defaulted Gulf Coast Hurricane disaster loans were serviced in accordance with loan provisions and regulations.

The OIG identified two areas of concern related to the transfer of files from the Disaster Assistance Processing and Disbursement Center (PDC) to the Loan Servicing Centers (LSC). First, due to the inadequate and untimely collection and filing of loan documentation, the PDC had not transferred either paper or electronic collateral files for 25,352 fully-disbursed loans. Many of these loans had been fully disbursed for at least a year. In June 2007, the PDC formalized specific guidelines for its File Forwarding team to research and resolve incomplete or inadequate collateral files prior to transferring them to the LSCs. However, loans assigned to this team were not adequately monitored to ensure that they were timely researched and forwarded for servicing. Second, 5,325 loans that were transferred to the El Paso LSC without physical collateral files were not serviced. Instead, the LSC held these loans in suspense while awaiting receipt of the physical collateral files. These loans were not properly serviced and no collection activities were initiated, which could ultimately lead to an increase in loan defaults and loss to the Agency.

The report recommend that the Associate Administrator for Disaster Assistance: (1) transfer all electronic loan files held by the PDC to the appropriate LSC for timely servicing and collection activities once the loans are fully disbursed; (2) revise current policy to identify specific time requirements for the transfer of physical electronic files from the PDC to the LSCs; and (3) adopt current servicing standards used by the El Paso and Birmingham LSCs for loans that have not been transferred from the PDC. The report also recommend that the Director, Office of Financial Assistance: (1) direct the El Paso LSC to automatically assign all loans to a servicing team upon receipt of electronic loan files from the PDC and to complete servicing of the 5,325 unassigned loan files; and (2) revise current policy to include specific time requirements for collection actions on delinquent loans.

Houseboat Owner Sentenced. On June 11, 2008, a Gulf Coast houseboat owner was sentenced to five years probation and ordered to pay $17,790.08 in restitution. He previously pled guilty to one count of false statements. He received an SBA Disaster Home Loan in the amount of $21,800 to replace a destroyed houseboat, which was his residence at the time Hurricane Katrina impacted the Gulf Coast region. He falsely represented that he had complied with the terms of his SBA Disaster Loan Authorization and Agreement requiring him to spend the initial $10,000 of loan proceeds towards the purchase of a new houseboat.

Mississippi Man Indicted. On June 11, 2008, a Mississippi man was indicted on one count of false claims, three counts of false statements, two counts of theft of government funds, one count of fraud in connection with a SBA loan, seven counts of wire fraud, and one count of mail fraud. The charges relate to allegations that he made false statements on his claims for disaster benefits after Hurricane Katrina. Specifically, he indicated that his primary residence was in an area affected by the storm when allegedly it was not. He received $179,400 from the SBA and $14,006 from the Federal Emergency Management Agency. He also applied for a Mississippi

Development Authority Homeowner Assistance Program Grant, which was suspended pending the results of the investigation. The OIG is conducting this investigation jointly with the Department of Homeland Security (DHS) OIG, the Housing and Urban Development (HUD) OIG, and the Mississippi State Auditor's Office.

Government Contracting and Business Development

OIG Issues Report on the Acceptance of VBP Group Into the 8(a) Program and Subsequent Contract Award by SBA. On July 18, 2008, the OIG issued a report that provided the results of our review of VBP Group's acceptance into the 8(a) program and SBA's contract award to VBP for training services. The OIG reviewed VBP's initial 8(a) application, SBA's initial rejection of the application, VBP's reconsideration request, and documentation supporting SBA's approval of VBP's application. The review found that SBA granted VBP 8(a) certification without ensuring that the company met all of the Agency's requirements for acceptance into the 8(a) program. With approximately 4 months in business, VBP had the least amount of experience of any of the firms accepted into the 8(a) program during the 2-year timeframe that was reviewed. Further, at the time of its application for reconsideration, VBP's only completed contract was just 11 days in duration and outside the primary industry for which it was approved.

SBA's approval was based on documents submitted by VBP that were false or of questionable authenticity. In making its decision to accept VBP into the 8(a) program, SBA relied heavily on contracts that VBP claimed to have with the U.S. Department of Agriculture (USDA). A more thorough examination by SBA would have disclosed that VBP did not have the claimed contracts with USDA or the related income. VBP's owner, Vernon Parker, also falsely certified that he was not a Federal employee. A review of USDA personnel records showed that Mr. Parker was an employee at the time of application, and records of bank deposits submitted to evidence VBP's contracts with USDA were redacted by Mr. Parker to disguise that the deposits were for his Federal salary. The circumstances surrounding SBA's certification were also unusual. VBP's electronic request for reconsideration was recommended for approval on a Sunday, within 19 minutes of SBA's receipt of the request. The log-in accounts of both the Business Opportunity Specialist (BOS) who recommended approval and his supervisor were accessed that Sunday, and login/logout entries were closely timed. The BOS and his supervisor both confirmed that the BOS and other coworkers had the supervisor's password and frequently logged into the system as the supervisor. Therefore, it is plausible that the BOS made both the initial recommendation for and the subsequent supervisory approval of VBP's application. Finally, SBA awarded VBP a sole source contract without assessing VBP's intentions to meet the limitations on subcontracting, especially since VBP only had two employees at the time of award and had informed the Agency that it planned to rely heavily on the subcontractors who had provided training under the previous contract.

The OIG recommended that SBA: (1) immediately suspend VBP from the 8(a) program and initiate termination proceedings; (2) initiate debarment proceedings for VBP under either SBA's nonprocurement debarment and suspension procedures or the FAR (if immediate action is necessary to protect the Government's interest, impose suspension under those rules); (3) initiate termination proceedings on the VBP training contract as soon as practicable; (4) establish additional guidelines on when it is appropriate to waive the 2-years in business rule, and strengthen controls for ensuring that applicant firms granted 8(a) certification have adequate records of performance to succeed in the program; (5) take appropriate action to address the breach of access controls over the 8(a) and SDB Certification System committed by the San Francisco Division of Program Certification and Eligibility, and reinforce the importance of adhering to the Agency's policy on maintaining password integrity; (6) review a sample of other 8(a) certifications made by the San Francisco Division of Program Certification and Eligibility since June 2006, with a focus on those that involved a waiver of the 2-years in business rule, to ensure that they were properly made; and (7) require an assessment of contractor ability to comply with subcontracting limitations at time of contract award, and require sufficient labor cost detail be obtained to properly evaluate continued compliance.

As a result of this audit, the SBA suspended VBP from the 8(a) program and initiated termination proceedings.

OIG Issues Report on Blackwater Contracting. In response to a request from the House Committee on Oversight and Government Reform, which was referred to the OIG by the Agency, the OIG performed a review to determine whether Blackwater Worldwide (Blackwater) and its affiliated companies complied with Federal small business laws. The review of Federal procurement data found that during Fiscal Years 2005 - 2007, Blackwater or an affiliate obtained 39 contracts that were set aside for small businesses even though the bidder may not have qualified as a small business under the contract. The SBA OIG referred these contracts to the OIGs at the Departments of Defense and Veterans Affairs to determine whether the contracts were awarded based upon misrepresentations.

During a review of statements made by a Blackwater affiliate to SBA for a 2006 size determination, the OIG identified questions about SBA's conclusion that the affiliate was a small business. The key issue in the decision was whether personnel hired by Blackwater to provide security services for various agencies in Iraq and elsewhere were Blackwater employees (which would have meant that the protested firm was not a small business) or independent contractors. The review found that: (1) SBA did not adequately explain its reasons for concluding that the security personnel on the contract were independent contractors; (2) SBA did not follow up on or attempt to reconcile conflicting information in its files that the total number of Blackwater employees -- even excluding the security personnel hired under federal contracts -- exceeded the applicable size standard; (3) SBA apparently did not consider certain contractual terms that appear to be inconsistent with its conclusion that Blackwater had little knowledge of the activities of the security personnel performing the contract and exercised little supervision over these personnel once they were deployed; and (4) that SBA did not appear to have considered information that Blackwater was the employer of the security personnel for purposes of the Defense Base Act. As the data made it appear likely that Blackwater and its affiliates would bid on future small business set-aside contracts, the report noted that SBA may want to examine its size decision to confirm whether it made the proper finding and determine whether it is appropriate for Blackwater affiliates to continue receiving small business set aside contracts.

Business Loan Programs

Ongoing Investigation Results in Indictments. The following cases are part of an ongoing investigation, being conducted jointly with the U.S. Secret Service (USSS), relating to a scheme in which a lender's former executive vice president and others conspired to fraudulently qualify loan applicants for SBA-guaranteed loans.

- On June 26, 2008, a Michigan man was named in a superseding indictment charging one count of fraud and related activity in connection with identification documents, authentication features, and information. The new count alleges that he intentionally transferred false identification documents knowing that such documents were prepared without lawful authority. He and his co-conspirator were previously indicted on charges of conspiracy, false statements, and aiding and abetting. His co-conspirator was also charged with false claims of citizenship. The charges relate to an $880,000 SBA-guaranteed loan made by a Michigan lending company to the co-conspirator d.b.a. a Michigan mini-mart. The Michigan man was the seller in this commercial real estate transaction. It is alleged that he made or caused to be made a false "gift affidavit" affirming that the co-conspirator received a gift of $300,000, the amount of the required equity injection, and that the co-conspirator falsely claimed that he was providing the equity injection from his personal liquidity. The co-conspirator pled guilty to a one-count superseding information and was sentenced to probation and home confinement.

- On July 9, 2008, a Michigan escrow agent and another Michigan man were named in a superseding nine-count indictment. The indictment charged conspiracy, conspiracy to commit wire fraud, false statements, and aiding and abetting relating to falsifying equity injections and loan disbursements on HUD settlement statements involving twelve SBA-guaranteed loans. The indictment alleges that the Michigan man acted as a broker and recruited "straw buyers" to falsely obtain SBA-guaranteed loans. The indictment also alleges that the escrow agent, who was employed at a Michigan title company and was later an owner of a Michigan title company, conducted the loan closings and knowingly falsified HUD settlement statements regarding loan disbursements and equity injections. Upon completion of closings, the fraudulent loan proceeds were wire transferred from an account held by the lender to an account held by the title company. On July 11, 2008, the Michigan man was arrested by agents from the OIG and the USSS.

South Dakota Guarantor Sentenced. On June 18, 2008, a guarantor on an SBA 504 loan to a marina located in Fort Pierre, South Dakota was sentenced to 36 months imprisonment; 12 months supervised release, and was ordered to pay $89,041 in restitution. The investigation determined that the guarantor submitted false Personal Financial Statements and false tax returns in support of a 504 loan application. He falsely represented that he had no tax liability and that he had filed tax returns for 2001, 2002, and 2003. The 504 loan was approved by the SBA in the amount of $239,000 but not funded because of the guarantor's legal problems. The OIG is conducting this investigation jointly with the Internal Revenue Service (IRS).

Chicago Business Owner Sentenced. On June 25, 2008, a Chicago area business owner was sentenced to 24 months in prison, two years probation, and a $7,500 fine pursuant to a plea agreement filed on April 25, 2007. The business owner had submitted a loan application through SBA's 504 loan program for $594,000 to buy and improve property for his interstate trucking firm. Although the business owner claimed on the application that he was a U.S. citizen, the investigation revealed that he was residing in the U.S. illegally. When SBA requested evidence of naturalization, he presented a counterfeit certificate of naturalization and offered a $5,000 cash bribe to an SBA official. The OIG conducted this joint investigation with DHS/Immigration and Customs Enforcement (ICE). The Illinois District Office provided significant cooperation in this case.

U.S. Treasury Forfeiture Fund Recovers Money. On July 8, 2008, the government of St. Kitts wired $149,213.20 to the U.S. Treasury Forfeiture Fund from a bank account that the U.S. Attorney's Office (USAO), Central District of California, and the U.S. Department of Justice, Office of Foreign Litigation, successfully froze in 2002. The recovery resulted of an investigation involving a mother and her son, both of whom engaged in a scheme to defraud two banks and the SBA of $550,000. The scheme involved the submission of false purchase orders for supplies, machinery, equipment, and other manufacturing costs from "shell" businesses they created prior to submitting SBA loan applications. Once the loans were approved, the banks issued disbursement checks made payable to the shell vendors. The mother and son picked up the checks at the mailboxes they had created, deposited the funds into various bank accounts they opened for the shell businesses, and then funneled the money to an offshore bank account in St. Kitts. The mother and son fled to Greece to avoid prosecution and remain fugitives. The OIG conducted this investigation jointly with the IRS Criminal Investigation Division (CID).

Montana Bank Agrees to Settle Litigation. On July 15, 2008, a Montana bank agreed to settle civil litigation which was initiated by the Montana U.S. Attorney's Office. The bank agreed to waive any claim to SBA's loan guaranty worth $999,900, agreed to waive any claim to an SBA guaranty loan fee rebate worth $34,996.50, and was required to pay $15,003.50 to the Department of Justice. The OIG investigation revealed that a computer services company submitted a loan application through the bank to the Montana SBA District Office. The computer services company requested a $1.8 million line of credit with a large portion going to pay-off an existing line of credit with the bank. SBA declined the loan and advised that the company could not refinance their bank debt with an SBA loan. The bank submitted a new loan application for the company to the SBA loan processing center in Sacramento, California. This time the company requested a $1.8 million SBA loan to purchase equipment and software. The loan was approved, and the bank received a 55.55% SBA guaranty. The bank failed to reveal the previous loan application to the Sacramento loan processing center. In addition, the bank and the company submitted a false settlement sheet showing loan proceeds were used for equipment and software when in fact the proceeds went to repay the company debts owed to the bank.

Identity Theft Ring Principal Charged. On July 17, 2008, a principal involved in an identity theft ring was charged with one count of bank fraud and one count of mail fraud. He subsequently pled guilty on July 29, 2008, to both counts. The investigation revealed that he was involved in a sophisticated identity theft ring operated for the sole purpose of obtaining fraudulent

SBA*Express* lines of credit, conventional and/or residential loans, and credit cards. The scheme involved the principal and other known suspects obtaining financing by creating fictitious businesses and purchasing legitimate social security numbers assigned to others. The investigation further revealed that he falsely claimed on his SBA*Express* loan documents that he was a United States citizen and that he did not have a prior criminal history. The evidence showed that he was in fact an Israeli National in the United States illegally and had a prior felony conviction in Canada for an ATM credit card skimming scheme. He received a $5,000 SBA*Express* loan, as well as a bank car loan for $94,363. The OIG is conducting this investigation jointly with the Los Angeles Police Department, California Department of Insurance, DHS/ICE, the U.S. Postal Inspection Service (USPIS), and the Social Security Administration OIG.

Turkish Nationals Indicted. On July 24, 2008, two Turkish nationals were indicted on charges of conspiracy to commit bank fraud and bank fraud. They are alleged to be members of an organized group of Turkish nationals who are obtaining credit cards and loans from various financial institutions using false identities, documents, and businesses. Twenty-five SBA*Express* loans, totaling approximately $1,000,000, have been identified with this group. A large percentage of these SBA-guaranteed loans are in default. Both men allegedly obtained five SBA-guaranteed Express loans totaling $150,000 and made the payments using fraudulent credit cards. These payments were subsequently returned by the banks as having insufficient funds. The OIG is conducting this investigation jointly with the USPIS.

Accounting Business Owner Sentenced. On July 28, 2008, the owner of an accounting business located in Montclair, New Jersey, was sentenced to three years probation, $40,000 in restitution, a $3,000 fine and a $100 special assessment fee. Previously, he pled guilty to one count of money laundering and one count of aiding and abetting involving a scheme to defraud the SBA. He prepared a fraudulent tax record at the request of a suspended New Jersey attorney who was facilitating, for a fee, an SBA loan application for a Philadelphia-based supermarket company. The purpose of the fraudulent tax record was to increase the likelihood that the supermarket's loan would be approved by making it appear that its financial condition was stronger than it actually was. The supermarket ultimately obtained an SBA-guaranteed loan in the amount of $993,000 through a small business lending firm in Livingston, New Jersey. Both the owner of the supermarket and the suspended attorney have entered guilty pleas in this matter and have been sentenced. The OIG is conducting this investigation jointly with the Federal Bureau of Investigation (FBI).

Surety Bond Guarantee Program

Construction Company President Pleads Guilty. On July 3, 2008, the president of a Washington State construction company pled guilty to one count of false statements on a loan application and one count of false statements to the SBA. The construction company, now defunct, performed public works contracts for state agencies and city municipalities. The construction company obtained SBA-guaranteed surety bonds in order to perform those contracts. The plea relates to the company's president falsely stating that he had paid subcontractors and suppliers; falsely claiming to the surety company that the construction company was out of funds when, in fact, he had diverted and was continuing to divert contract proceeds of approximately $87,000 to his personal use; making false statements to a federally-insured financial institution regarding a mortgage loan; and falsely stating to the SBA that he had not defaulted on prior surety bonds. The SBA suffered a loss of over $500,000 due to the construction company's defaults on several contracts. The SBA's surety bond program guarantees 70% of the surety company's losses on bonded jobs the SBA has guaranteed. This matter was referred to the OIG by the National Insurance Crime Bureau (NICB). The OIG is conducting this investigation with the FBI and the NICB.

Kentucky Business Consultant Found Guilty. On July 9, 2008, a business consultant to an architectural services company in Louisville, Kentucky was found guilty by a Federal jury on two counts of making false statements to the SBA. The consultant submitted two HUBZone applications on behalf of the company that contained false statements regarding the office address of the company and the number of employees living in a HUBZone. The OIG is conducting this investigation in conjunction with the Defense Criminal Investigative Service.

Company Owner Charged. On July 25, 2008, the president and owner of a Maryland environmental services company was charged in a criminal Information with one count of conspiracy to defraud the SBA. The company was a participant in the SBA 8(a) program from April 1999 to February 2008 based on the owner's qualification as a disadvantaged individual. The Information alleges that, in order to maintain his company's 8(a) eligibility, he failed to disclose that non-disadvantaged individuals provided critical bonding, insurance, financial support, and control over the company. The non-disadvantaged individuals have also been charged. On July 22, 2008, one co-conspirator was charged with one count of conspiracy to defraud the SBA and one count of money laundering conspiracy. On July 28, 2008, another co-conspirator was charged with one count of conspiracy to defraud the SBA. It is alleged that both individuals conspired to violate SBA requirements by not disclosing their actual financial support, control, and ownership of the owner's company, as well as two additional companies. The non-disadvantaged individuals received approximately $900,000 more in bonuses and salaries than the owner between 2002 and 2004. The OIG is conducting this investigation jointly with the Environmental Protection Agency CID, the Naval Criminal Investigative Service, the FBI, and the IRS CID.

This monthly update is produced by the SBA OIG, Peter L. McClintock, Acting Inspector General.

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