



Office of Inspector General Small Business Administration

March 2002 Update

Business Loan Programs

Audit Report of SBA-Guaranteed Loan Issued. On March 21, 2002, an audit report on an SBA-guaranteed loan concluded that the **lender did not exercise reasonable care in protecting SBA's financial interest** by using unsupported information to evaluate the borrower's repayment ability. According to SBA's standard operating procedures the ability to repay a loan from the cash flow of the business is the most important consideration in the loan making process. Also, the lender did not take prudent measures to ensure that the borrower injected equity of \$43,329 into the business as required. OIG recommended that the Dallas/Ft. Worth District Office seek recovery of \$116,772, less any subsequent recoveries for the loan in question. The district office agreed with the recommendation.

Audit Report of SBA-Guaranteed Loan Issued. An audit report on an SBA-guaranteed loan issued on March 29, 2002, showed that **the lender did not ensure that the borrower injected the required amount of equity into the project.** The lender was required to obtain evidence that the principal injected \$255,000 of equity into the business prior to the first loan disbursement. The borrower submitted an accounting of equity injection expenditures for the project of \$447,331. A review of the documentation in the lender's loan file showed that only \$191,503 of the expenditures qualified as equity injection. As a result of eliminating the unqualified expenditures, the equity injection shortfall was \$63,497. OIG recommended that the Colorado District Office seek recovery of \$63,497 on the guaranty paid, less any subsequent recoveries. The district office agreed with the recommendation.

Audit Advisory Memorandum on Asset Sale Issued. On March 29, 2002, OIG issued an audit advisory memorandum detailing the results of a certified public accountant (CPA) firm's review of one of the Agency's asset sale due diligence contracts. SBA hired the CPA firm to verify the billings of the contract. OIG reviewed the CPA's work and brought to management's attention two situations where the **CPA's work was not adequate.** Specifically, OIG noted that the CPA used computer-generated data provided by the due diligence contractor to support its review results without performing tests to ensure data reliability. Additionally, OIG noted that the CPA's conclusion that the due diligence contractor over-billed by \$620,996 was in error because the CPA had made miscalculations when checking the billings. OIG recommended that the Associate Administrator for Financial Assistance ensure that the due diligence contractor's database be validated and transaction testing be accomplished to ensure data accuracy and reliability prior to reaching a negotiated settlement with the due diligence contractor on the reviewed asset sale.

President of Texas Construction Company Pleads Guilty to Bank Fraud. The president of a Plano, Texas, construction company pled guilty on February 11, 2002, to a criminal information charging him with one count of **bank fraud** in connection with an SBA-guaranteed business loan. His scheme fraudulently influenced an Oklahoma bank to disburse \$105,340 in loan proceeds to his company. The defendant presented documents to the bank falsely representing that the company had purchased \$131,675 of equipment from a rental company. His sentencing is scheduled for June 3, 2002.

OIG's joint investigation with the Federal Bureau of Investigation (FBI) was based on a referral from SBA's Oklahoma District Office.

Co-Owner of Connecticut Dry Cleaning Business Sentenced. A former co-owner of a dry cleaning business in Southington, Connecticut, was sentenced on March 12, 2002, to 3 years probation and \$100,000 restitution (80 percent to SBA). She previously pled guilty to one count of **making a false statement to a bank**. In April of 1998, the business obtained a \$100,000 SBA-guaranteed loan. The defendant stated to the bank that she and her co-owner had previously purchased \$98,000 of new equipment using their own funds and needed the \$100,000 for working capital. The investigation revealed that she submitted false documents to the bank, including phony checks and invoices, representing their capital injection into the business. Further, 1 month prior to obtaining the SBA loan, she and her co-owner had obtained an \$85,000 loan through a private lender using a different company name with which they purchased various pieces of equipment. The private lender was given first lien position on the collateral, but the business did not disclose this debt relationship to the bank in its SBA loan application in which it pledged the same equipment. The business defaulted on the SBA loan in November of 1998. The bank and SBA were unable to recover any of their loss because the private lender had taken possession and sold the equipment. OIG initiated the investigation based on a referral from SBA's Connecticut District Office.

Owner of Import/Export Companies Arrested for Bank Fraud, Wire Fraud, and Conversion of Property Pledged to SBA. On March 20, 2002, special agents of OIG and FBI arrested the former owner of an import/export company in Tumwater, Washington, and several other exporting companies in Washington, Florida, and the Netherlands. These businesses were involved in the sale of floral evergreen products that were picked in the Pacific Northwest and shipped within the United States and to the Netherlands and other European countries. On March 18, 2002, a Federal grand jury in Seattle, Washington, had returned a 50-count indictment charging the defendant, a Netherlands citizen, with (among other crimes) **bank fraud, wire fraud, and conversion of property pledged to SBA**. From 1997, until 2000, the defendant allegedly submitted false documents to a Seattle bank in order to obtain draws on various lines

of credit, including a \$1.3 million line guaranteed by SBA. The defendant also allegedly diverted payments away from the participating lender to another bank account under his control. He then allegedly used some of the proceeds from the draws and the diverted proceeds for unauthorized personal expenses.

The indictment also charges that from 1998, to 2000, he engaged in a scheme to defraud the Government of the Netherlands and the European Community by submitting false invoices via wire for the purpose of paying them lower customs duties and taxes. OIG investigated this case jointly with FBI and the Fiscal Intelligence and Information Service, an agency of the Government of the Netherlands.

President of Pennsylvania Clothing Manufacturer Indicted for Making Material False Statements. The president of a Middletown, Pennsylvania, business that makes and sells Civil War era clothing was indicted on March 20, 2002, on one count of **making a material false statement** to SBA. In 2000, she applied for a \$243,000 SBA-guaranteed loan to purchase land. She allegedly submitted false Federal tax returns for 1997, through 1999. This was discovered when the lender bank found discrepancies between the copies submitted and those on file with the Internal Revenue Service (IRS). The lender cancelled the loan before it made any disbursements. OIG initiated this investigation based on information received from the bank.

Former President of Missouri Boat Propeller Manufacturer Indicted for Making Material False Statements. The former president of a manufacturer of boat propellers in Ozark, Missouri, was indicted on 12 felony counts on March 22, 2002. Counts 1 and 2 charged that he made **material false statements** to two banks regarding a \$340,000 SBA-guaranteed loan. He allegedly failed to disclose numerous personal and corporate liabilities and submitted fraudulent documents to obtain loan disbursements. The defendant, who is a disbarred attorney, defaulted on this loan, resulting in a loss of \$224,370. Counts 3 through 11 charged him with **mail fraud** that bilked investors in another defunct corporation operated by the defendant out of over \$1 million. The defendant allegedly lied to investors about the intended use of their investment. He used their funds to pay interest and principal to investors, for his own personal use, and for the use of other businesses he owned and

controlled. Count 12 charged him with **laundering funds** in connection with his mail fraud scheme. OIG's joint investigation with the Criminal Investigations Division of IRS and the Missouri Attorney General's Office was initiated based on a referral from SBA's Springfield, Missouri, Branch Office.

Connecticut Businessman Indicted on Fraudulent Concealment of Property-Bankruptcy Estate. A businessman in Washington Depot, Connecticut, was indicted on March 26, 2002, on one count of **fraudulent concealment of property-bankruptcy estate**. The indictment relates to a \$450,000 SBA-guaranteed bank loan obtained by the defendant's Danbury, Connecticut, printing company in 1996. The defendant personally guaranteed the loan. Approximately 3 weeks after obtaining the loan, he filed for personal bankruptcy. He allegedly concealed his ownership of the printing company, listing himself as a salesman, as well as his ownership interest in two other companies. The defendant also allegedly concealed his personal guaranty of the loan and his personal assets, including \$250,000 in trusts. The printing company then defaulted on the SBA-guaranteed loan in 1998, after filing corporate bankruptcy with an outstanding loan balance of \$355,000. By allegedly concealing his personal guaranty of the loan on his personal bankruptcy, he caused the bank not to be notified by the bankruptcy trustee, thereby not allowing the bank to reaffirm his guaranty or take any other protective measures. OIG initiated the case based upon information provided by the SBA Connecticut District Office.

Disaster Loan Program

Report Issued on Early Defaulted Disaster Loan. On March 20, 2002, OIG issued a report on a disaster loan that defaulted soon after approval. The objective of the review was to determine whether the loan default was due to SBA non-compliance with its policies and procedures, borrower non-compliance with the loan agreement, or borrower misrepresentations. **OIG identified four issues warranting management's attention:** (1) unverified information relied on to determine borrower benefits; (2) use of loan proceeds for unauthorized purposes; (3) lack of support for 80 percent of funds received; and (4) false statements by the borrower which were not referred to OIG. OIG requested the program office maintain documentation of actions taken.

Report Issued on Another Early Defaulted Disaster Loan. On March 26, 2002, OIG issued an audit report on another early defaulted disaster loan. The borrower defaulted on the SBA loan because of a lack of repayment ability. This occurred because an **SBA loan officer miscalculated a portion of the borrower's wages and a discrepancy in financial information reported** on the application was not reconciled against wages shown on the Federal tax return or other verifiable sources. Consequently, the wages used to calculate repayment ability were overstated. OIG suggested that SBA periodically remind disaster loan officers of the importance of following all established SBA loan-making procedures.

Small Business Investment Companies

Former Small Business Investment Company (SBIC) Owner Signs Settlement Agreement to Pay SBA \$490,000. On February 26, 2002, the former owner of an SBIC in Washington, DC, and his wife signed a settlement agreement to pay SBA \$490,000. The former owner made the first payment of \$50,000 on February 26, 2002, and agreed to pay the remainder in two installments. If he does not adhere to the terms of the agreement, he will forfeit the \$50,000 already paid to SBA, and an earlier judgment (described below) will be enforced against him.

In late 1994, SBA's Office of General Counsel provided a memorandum to OIG alleging that the owner had misspent funds of the SBIC for personal and other unauthorized uses. Based on this information, OIG initiated an investigation and referred our findings to the U.S. Attorney's Office for the Eastern District of Virginia. The case was accepted for criminal prosecution. Meanwhile SBA, as receiver of the liquidated SBIC, pursued a civil action against the SBIC. In August 1995, a more than \$5.4 million civil judgment (including both compensatory and punitive damages) was filed against the owner.

In January 1996, he agreed to plead guilty to one count of **making material false statements**, a felony. In exchange for his expected plea and payment of \$800,000, the Government agreed not to pursue the civil judgment. After the plea agreement was drafted, however, his attorney repeatedly delayed its signing. In September 1997, it was decided that the plea agreement would be revised to reflect a misdemeanor

violation, but the Assistant U.S. Attorney assigned to the case was then detailed to an Independent Counsel's staff for an extended period of time. After repeated requests from OIG, this case was reassigned to another prosecutor in February 2000. The U.S. Attorney's Office declined to prosecute criminally in October 2000, because the statute of limitations had expired before any action was taken. OIG then contacted SBA's Investment Division (ID) in an effort to address this as a non-criminal matter. OIG worked with ID to identify additional assets of the owner. Their joint efforts resulted in the settlement described above.

Entrepreneurial Development Programs

Advisory Memorandum Report Issued on SBA's Evaluation and Monitoring of Women's Business Center. On March 19, 2002, OIG issued an Advisory Memorandum Report on SBA's evaluation and monitoring of a women's business center in Vermont, based on issues identified during a previous audit of the center. The audit disclosed **areas for improvement that could be applicable to all women's business centers** in the areas of: (1) reviewing proposed budget and cost information; (2) reviewing staffing roles and experiences; and (3) monitoring the financial and performance aspects of the award. As a result, the auditors made eight recommendations to the Associate Administrator, Office of Women's Business Ownership (OWBO) and three recommendations to the Assistant Administrator for Administration to help strengthen the administration of the Women's Business Center Program. OWBO agreed with all of the recommendations addressed to them. The Office of Administration agreed with one of the recommendations addressed to them and provided a rebuttal with supporting documentation for the other two. The auditors analyzed the rebuttal and supporting documentation and determined that the recommendations should remain.

Agency Management

Agreed-upon Procedures Report on SBA's Federal Agencies' Centralized Trial Balance System (FACTS) Data Issued. As part of SBA's annual financial statement audit, OIG's independent auditors performed agreed-upon procedures to determine if SBA's summarized FACTS data is consistent with the FY 2001 financial statements. The auditors found

differences in reported amounts between SBA's FACTS data and its audited financial statements for two accounts, two line items, and the Account Groupings Worksheet (AGW) FACTS NOTES. Additionally, the auditors found that several line items on the AGW Statement of Changes in Net Position did not total due to errors on Treasury Department's template.

Agreed-upon Procedures Report on SBA's Intra-governmental Activity and Balance Data Issued. As part of SBA's FY 2001 financial statement audit, OIG's independent auditors performed agreed-upon procedures on SBA's summarized intra-governmental activity and balances data and determined if there are differences between SBA's data and its trading partners' data, whether these differences were reconciled, and whether documentation and information is available to clearly explain these differences. The auditors found differences in account balances with three of SBA's trading partners. The auditors found that SBA did not clearly explain the differences with two of these trading partners, nor did SBA have documentation to reconcile these account balances

Office of Inspector General

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