



Office of Inspector General Small Business Administration

May 1996 Update

Business Loans

California Gas Station Owner Indicted for Forgery and Possession of Stolen Mail. The owner of a gas station in San Diego, California, was indicted on April 10, 1996, on 15 counts of **forging U.S. Treasury checks** and 2 counts of **possession of stolen mail**. The Secret Service asked the OIG to join its investigation which had identified \$340,000 in stolen U.S. Treasury checks deposited into the man's business bank account. The OIG's portion of the investigation also confirmed that he had obtained an \$80,000 SBA-guaranteed loan from a participating lender bank for business improvements. As part of his application, the man provided "copies" of 3 years' corporate income tax returns which, as he admitted when interviewed, significantly overstated the business' taxable income. In the returns filed with the Internal Revenue Service (IRS), the business reported losses for the 3-year period. Prosecutorial decisions concerning the improper \$80,000 SBA-guaranteed loan have not yet been resolved with the cognizant U.S. Attorney.

Utah Motorcycle Dealer Pleads Guilty to Bank Fraud. An owner of

a motorcycle dealership in Salt Lake City, Utah, pled guilty on April 22, 1996, to one count of **bank fraud**. The dealership had received a \$185,000 SBA-guaranteed loan in 1979, pledging as collateral three pieces of real property. The felony information charged that in the fall of 1993, when the loan was in serious default, the owner caused the filing of reconveyance documents, fraudulently releasing the liens on the properties. Having obtained release of the liens, he pledged two of the properties to another Federally-insured bank to obtain an additional \$150,000 in financing. The OIG investigation also determined that he forged the signature of a former officer of the participating lender bank on the release of lien documents. The investigation was initiated based on a referral from the Salt Lake City District Office.

California Jeweler Pleads Guilty to Making a False Statement. A former owner of a retail jewelry company in Garden Grove, California, pled guilty on May 9, 1996, to one count of **making a false statement on a loan application to a Federally-insured financial institution** in connection with his \$100,000 SBA-guaranteed business loan. The man

was identified in one of an ongoing series of joint OIG/FBI investigations examining the inclusion of false tax returns and false invoices in applications submitted to SBA's participating lenders by loan packagers. The investigation revealed that the jeweler submitted bogus tax returns for the years 1987 through 1989 which significantly overstated his income. The OIG initiated this investigation based on a referral from SBA's Los Angeles District Office.

California Father Convicted for Bank Fraud and Making a False Statement. A Woodland Hills, California, man was convicted on May 9, 1996, on charges of **bank fraud** and **making a false statement to a Federally-insured lender**. His daughter had also been indicted on two charges, which were previously dismissed based on her claim that, at only 18 years of age, she had not understood the significance of the documents she signed. The OIG investigation revealed that the daughter's application for a \$665,000 SBA-guaranteed loan to purchase real property for the operation of a nursery contained false financial documents, including false tax returns. Her father, acting under an alias, had purchased the property for \$450,000 and then immediately sold it to her for \$900,000, thereby doubling its purchase price. The participating bank financed the purchase based on this inflated price. The man also falsely represented to the bank that he was giving his daughter a gift of

\$160,000 toward the purchase of the property. The nursery never opened for business, and the loan went into default after only two loan payments had been made. Because of statements the father made about a plan to flee the country should he be convicted, the court immediately remanded him into the custody of the U.S. Marshals Service following the jury verdict. The OIG initiated this investigation based on a referral from the Los Angeles District Office.

Pennsylvania Restaurant Owner and Associate Sentenced for Conspiracy and Making False Statements. The owner of a restaurant in Downingtown, Pennsylvania, and his associate were sentenced on May 23, 1996. The owner was sentenced to 4 months home detention, 3 years probation, a \$1,500 fine, and a \$150 special assessment; his associate was sentenced to 200 hours community service, 2 years probation, and a \$150 special assessment. Each had pled guilty to **conspiracy** and **making false statements** in connection with the owner's application for a \$65,000 SBA-guaranteed loan for his business. The OIG's investigation found that the woman prepared and the owner signed and submitted false Federal income tax returns to a participating bank. The returns showed a net profit of more than \$40,000 for each of the years 1993 and 1994; however, the restaurant actually incurred losses in both years. On learning that the tax returns submitted as part of the application differed significantly from

those on file with the IRS, SBA canceled the loan before any proceeds were disbursed. The discrepancies, which were detected by SBA's tax return verification program, were referred to the OIG by the Philadelphia District Office.

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*Minority Enterprise
Development*

Florida Technology Contractor Acts Improperly as Broker. An OIG audit revealed that a technology firm in Fort Walton Beach, Florida, **acted improperly as a broker** on two Section 8(a) contracts awarded by the Air Force for \$4.5 million worth of computer systems. Almost all of the items in the audit sample were shipped directly from various manufacturers to the Air Force. The audit, initiated after a competitor's complaint, also found that the firm used the same method of operation on two service delivery orders totaling \$975,000 with the Department of Defense. The contractor could not document that it had performed 50 percent of the labor involved in filling the contracts.

Equipment and software representing \$878,000 of the "service" contracts was shipped directly from vendors to the procuring agencies.

The audit recommended that the Jacksonville District Office require corrective actions be taken by the firm and that procuring agencies be informed of the violation of SBA

regulations, so they can consider recovery of profits under the principle of unjust enrichment. The District Office has ordered corrective actions by the firm; however, a decision regarding the unjust enrichment issue is still in the audit resolution process.

Illinois Construction Company President and Accountant Sentenced for Obstruction of Justice. The president of a Section 8(a) construction company in Villa Park, Illinois, and the company's accountant were sentenced on April 26, 1996. The president was sentenced to 6 months home detention, 3 years probation, a \$25,000 fine, and \$10,000 restitution. The accountant was sentenced to 3 years probation and a \$1,000 fine. Each had pled guilty to one count of **obstruction of justice**. The OIG's joint investigation with the Air Force Office of Special Investigations (AF/OSI) revealed that, from about August 22, 1990, through January 7, 1991, the men submitted fraudulent claims to SBA and the Air Force pertaining to a Section 8(a) contract for landscaping on the Air Force Reserve Facility at O'Hare International Airport. During the course of the subsequent investigation, both men provided false testimony to a Federal grand jury and attempted to tamper with witnesses whose testimony was to be presented to the grand jury. The AF/OSI asked the OIG to join the investigation.

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Disaster Assistance

North Carolina Businessman Sentenced for Making False Statements and Mail Fraud. The owner of a Charlotte, North Carolina, furniture franchisee was sentenced on April 1, 1996, to 6 months home confinement, 3 years probation, a \$10,000 fine, and \$300,000 restitution. He had pled guilty to one count each of **making false statements** to SBA and **mail fraud** in connection with a \$114,000 economic injury disaster loan approved in 1989. The OIG's joint investigation with the FBI disclosed that the man had submitted false statements regarding his personal financial condition and criminal history to induce SBA's approval of the loan in the aftermath of Hurricane Hugo. The investigation also showed that he had used the U.S. Mail in furtherance of his scheme to defraud SBA.

Georgia Man Indicted for Making False Statements. A St. Marys, Georgia, man was indicted on May 2, 1996, on nine counts of **making material false statements** to induce SBA to disburse a \$125,000 business disaster loan based on physical damage to a mobile home park. The investigation found that the man falsely represented that he had been the sole owner of a mobile home park and six mobile homes which were damaged or destroyed during a severe storm. He also falsely stated that he would use proceeds of the disaster loan to repair or replace the six mobile

homes. The OIG initiated the investigation based on information from an anonymous caller.

California Meat Market Owner Indicted for Filing a False Claim and Making False Statements. A former owner of a meat market in Huntington Park, California, was indicted on May 21, 1996, on one count of **filing a false claim** with the SBA and five counts of **making false statements** to the Agency. The OIG initiated the investigation of the owner following receipt of a letter from his insurance company. The investigation revealed that the man had received a \$174,100 disaster business loan following the 1992 civil unrest in Los Angeles, claiming extensive damage to his store from looting. The loan went into default after only two payments were made. Interviews with numerous witnesses confirmed that no looting took place at the market. When interviewed, he confessed that he had overstated his losses and admitted that he also inflated his income on the bogus tax returns submitted with the loan application. The IRS had no record of the owner having filed any tax returns for the years in question, 1988 through 1991.

Florida Veterinarian and Wife Plead Guilty to Making False Statements.

The president and owner of a corporation which operated veterinary clinics in Homestead and Miami, Florida, and his wife pled guilty on May 22, 1996, to two counts and one count, respectively, of **making false statements to SBA**. The company had received a

\$106,100 loan to repair or replace machinery, equipment, inventory, and real property damaged by Hurricane Andrew. The SBA/OIG investigation disclosed that, to obtain the loan and to conceal their misuse of some of the proceeds, the couple submitted fictitious receipts, invoices, and copies of checks as documentation of expenses that they had not incurred nor paid. The investigation was based on a referral from the Federal Emergency Management Agency's OIG.

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Agency Management and Financial Activities

Annual Audit of SBA's Financial Records Reveals Some Recurring Weaknesses but No Non-Compliance Issues. SBA's financial statements for FY 1995 received a qualified opinion in the annual independent audit because SBA did not: (1) maintain comprehensive inventory records of acquired property, (2) consistently value the acquired property at its net realizable value, and (3) reconcile certain fund balances with the U.S. Department of Treasury. The audit, required by the Chief Financial Officers Act of 1990, was performed for the Office of Inspector General by an independent public accounting firm.

The first two exceptions were repeated from the audit of the FY 1994 financial statements. Because of the lack of a comprehensive

inventory system with unit detail, SBA cannot reconcile the estimated \$140 million of collateral purchased property to its general ledger. A new computerized inventory system has been planned but not developed. The valuation question was addressed in an SBA Information Notice in October 1994; however, the auditors found the requirement for obtaining current appraisals of acquired property has not been consistently implemented.

The third exception relates to SBA's loan accounting balances, which were booked at \$32 million higher than balances carried by Treasury. Monthly reconciliations are required by the Treasury Financial Manual, but the difference had not been reconciled at the time of the audit. SBA retained a contractor to assist in the reconciliation and expects to become current by September 1996.

In the report on internal controls, the auditors classified the three problems with the financial statements as material weaknesses.

Six other control weaknesses were reported, including: (1) computer passwords are known to persons other than the owner, (2) SBA lacks policies and procedures to verify that accounting transactions initiated by field offices are complete and accurate, and (3) SBA has not performed the required annual re-estimate of disaster loan subsidy rates since 1991. In the report on compliance with laws and regulations, the auditors found no material non-compliance with laws and regulations tested during the

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

Comments or questions concerning this update or requests for copies of OIG audits, inspections, or other documents should be directed to Johnny Cahn, SBA/OIG, 409 Third Street, SW, Washington, DC, 20416-4110.

Telephone number: (202) 205-6580

FAX number: (202) 205-7382

If you are aware of suspected waste, fraud, or abuse in any SBA program, please call the OIG Fraud Line.

OIG FRAUD LINE (202) 205-7151
in Washington, DC metropolitan area

TOLL-FREE FRAUD LINE:
(800) 767-0385

Jones on May 10, 1996, in Houston, Texas.

Ms. Jones was SBA's primary investigator, and Mr. Ward was one of two auditors who worked with a large multi-agency task force to uncover and successfully prosecute 5 individuals and 5 companies for defrauding the National Aeronautics and Space Administration (NASA) or SBA. The case resulted in the largest fraud indictment and conviction in NASA's history, with potential fines and recoveries totaling approximately \$12 million.

audit.

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Other OIG News

OIG Auditor and Criminal Investigator Receive Special U.S. Attorney Awards. The United States Attorney's Office for the Southern District of Texas recently issued special commendations to Donald Ward, an auditor in the OIG's Los Angeles Field Office, and Cheryl Jones, a special agent in the OIG's Dallas Resident Office, for their outstanding performance, dedication, and professionalism in the investigation of a contractor supporting the space shuttle program at the Johnson Space Center. The awards were presented by U.S. Attorney Gaynelle Griffin