



Office of Inspector General Small Business Administration

April 2000 Update

Business Loans

Early Default Audit Issued. OIG issued an audit report on a \$855,000 loan that defaulted in July 1998. This review was part of the OIG's ongoing program to audit SBA-guaranteed loans charged off or transferred to liquidation within 36 months of origination (early default). The auditors concluded that the loan was not made in accordance with SBA rules and regulations. The lender did not perform a proper evaluation of the new business' projected income and consequently approved the loan to a borrower that lacked repayment ability at the time of loan origination. Ultimately, the borrower defaulted because sufficient cash flow was not available to service business debts. SBA could lose as much as \$635,981 if the guarantee is purchased.

OIG recommended that the loan guarantee be denied. Subsequently, the district office referred the loan to the Office of Financial Assistance to determine if the loan guarantee should be denied. SBA has not yet made a denial of liability determination.

New York Dentist Sentenced for Bank Larceny. A Williamsville, New York, dentist was sentenced on March 29, 2000, to 5 years probation, including 4 months home confine-

ment under electronic monitoring, and ordered to pay \$147,222 in restitution. He had pled guilty to one count of **bank larceny** in connection with a \$150,000 SBA-guaranteed loan. The investigation revealed that the dentist had leased, not purchased, equipment for his dental practice that he pledged as collateral for the loan. He instead used some of the loan proceeds to buy personal items such as stereo equipment, jet skis, motorcycles, and appliances. He failed to make the required lease payments, causing the leasing company to repossess the equipment that the lender and SBA thought was the security for the defaulted loan. The investigation, conducted jointly with the Federal Bureau of Investigation (FBI), was based upon a referral from SBA's Buffalo District Office.

Ohio Businessman Indicted for Aggravated Theft by Deception. A Montgomery County, Ohio, grand jury indicted a southwest Ohio real estate businessman on March 31, 2000. One count of the 40 count indictment charged him with **aggravated theft by deception** in connection with a \$439,000 SBA-guaranteed business loan. He allegedly deposited funds associated with a \$5 million bad check to an escrow account established with a title company. He allegedly induced the title company to issue a \$427,074 check from the escrow account, in the name of a Section 504 lender

based on his representations that these funds were designated for paying down the outstanding balance on the SBA loan. Allegedly, he forged an endorsement on the check and deposited the money to his business account instead. His trial scheduled for mid-June 2000. The Montgomery County prosecutor's request that OIG join its investigation was facilitated by SBA's Columbus District Office.

Two Californians Indicted on Five Counts of Making Material False Statements. Two officers of a residential real estate company in Santa Fe Springs, California, were indicted on March 6, 2000, on five counts of **making material false statements**. At the request of the U.S. Attorney's Office for the Central District of California, SBA/OIG joined the Department of Housing and Urban Development OIG, FBI, and the Internal Revenue Service (IRS) in their investigation. The business had obtained a \$550,000 SBA-guaranteed loan by using a false Social Security number (SSN) and fraudulent checks, submitting false financial statements, and omitting a criminal record from the SBA application. They also allegedly devised a double escrow scheme involving \$4.5 million in fraudulent Federal Housing Administration-insured loans, made in connection with the sale of eight properties, on which the defendants would then collect rent payments. The two were also charged with conspiracy, wire fraud, money laundering, and aiding and abetting.

Georgia Couple Indicted for Making Material False Statements. Two persons associated with the purchase of a day care franchise in Atlanta, Georgia, were indicted on April 11, 2000, on one count of **making material false statements** to induce a nonbank participating lender and SBA to fund a \$180,000 SBA-guaranteed loan. The couple allegedly signed loan documents verifying that they paid the seller \$105,000 in earnest money toward the purchase of the business. Actually, only

\$15,000 had been paid, and an undisclosed note for \$90,000 had been arranged. SBA/OIG conducted this investigation in response to a request from the lender and SBA's Georgia District Office.

Missouri Man Pleads Guilty to Mail Fraud, Wire Fraud, Making Material False Statements, Using False Social Security Number, and Impersonation of U.S. Government Officer. The president of a company in St. Louis, Missouri, pled guilty on April 17, 2000 (the first day of his trial), to one count each of **mail fraud, wire fraud, making material false statements, using a false Social Security number, and impersonation of a U.S. Government officer**. In return, the Government agreed to dismiss the other four felony counts on which he had been indicted. He had applied for a \$295,000 SBA-guaranteed loan in March 1999 to purchase and operate a day care center. The joint SBA/OIG, Department of Health and Human Services (HHS)/OIG, Social Security Administration/OIG, and Postal Inspection Service investigation confirmed that mailings were used in his scheme to submit false statements to a nonbank lender and SBA to obtain the loan. The investigation revealed that he made false statements regarding his educational background, work experience, criminal history, and financial status. The nonbank lender canceled the loan before disbursement. This investigation was initiated based on a referral from HHS/OIG.

Disaster Assistance

Illinois Businessman Sentenced to Prison for Making Material False Statements. The owner of a construction company in Silvis, Illinois, was sentenced on January 13, 2000, to 46 months incarceration, 3 years supervised release, and ordered to pay \$128,593 in restitution to SBA. He was previously

convicted on four counts of **making material false statements** to SBA in connection with a \$151,000 physical-damage disaster loan made to a campground located in Orion, Illinois, after the Midwest flood of 1993. Although he was an officer of the business, he omitted his name from the response to the loan application question asking for the names of the applicant's managers and officers. He did this to avoid disclosing that he had been convicted of and imprisoned for credit card fraud and was still on supervised release, which made the business potentially ineligible for SBA disaster assistance. To obtain disbursement on the loan, a construction agreement was submitted outlining the terms under which the construction company would replace and repair disaster-damaged property. OIG's investigation determined that he falsified the document in order for the construction company to realize \$70,000 more in profit. Also, he falsely represented that the loan proceeds would be used solely to rehabilitate and replace the disaster-damaged campground. He actually used some of the disaster loan proceeds to improperly fund pre-existing debt, expenses of his wife's real property management firm, a trip to Myrtle Beach, South Carolina, and gambling debts. OIG initiated this investigation based on a referral from SBA's Disaster Assistance Area 2 Office.

California Man Charged with Eight Felony Counts. On March 14, 2000, a California man was charged with eight felony counts (three counts of **perjury**, three counts of **filing false information with the California Department of Motor Vehicles (CalDMV)**, one count of **identity theft**, and one count of **grand theft** against SBA). A warrant for his arrest was issued on the same day. OIG special agents arrested him on March 20, 2000. OIG's joint investigation with CalDMV documented that, in 1995, the man obtained a \$137,300 disaster home loan following the Northridge earthquake using the name and SSN of his brother.

The charged man also quitclaimed his disaster-damaged Los Angeles property to his brother's name so the ownership of the property would match his forged identity. Lastly, he allegedly forged pay stubs and W-2 forms with his brother's name, SSN, and income to match the IRS verifications used by SBA to confirm applicants' income. In addition, the investigation showed that he had California driver's licenses (bearing his photograph) concurrently in his own name/date of birth and in his brother's name/date of birth. His pretrial arraignment date was April 12, 2000. OIG initiated the investigation based on a referral from SBA's Santa Ana Loan Servicing and Liquidation Office.

Agency Management and Financial Activities

SBA's General Controls Reviewed. As part of the audit of SBA's FY 1999 financial statements, the auditors reviewed the general controls over SBA's financial management systems to determine if those controls complied with various Federal requirements. General controls are the policies and procedures that apply to all or a large segment of an entity's information systems to help ensure their proper operation. They impact the overall effectiveness and security of computer operations, rather than specific computer applications.

The auditors concluded that SBA has made significant progress toward implementing an Agencywide systems security program, but that improvements are still needed. The report describes, for example, how (1) security policies and plans need to be established and implemented; (2) access controls need strengthening to reduce the risk of unauthorized activities; (3) application development and change control procedures need to be consistently applied; (4) programmers' access to operating systems needs to be controlled

and monitored; (5) segregation of duties controls need improvement; and (6) disaster recovery plans need to be completed and tested. The report also includes several recommendations for further implementing the agencywide systems security program.

SBA management agreed to address OIG's recommendations and implement solutions to improve information systems controls.

Former SBA Employee Pleads Guilty. A former SBA economic development specialist pled guilty on March 31, 2000, to one count of **knowingly possessing visual depictions of minors engaged in sexually explicit conduct.** As part of the plea agreement, the Government agreed to dismiss the other three counts on which he was previously indicted. After being indicted, the employee retired. OIG initiated the investigation after receiving complaints that he was accessing pornographic sites while on duty, using the computer SBA had assigned him. OIG presented the results of the investigation to an assistant U.S. attorney who requested that FBI join the case. His sentencing is scheduled for June 14, 2000.

The activity Update is produced by SBA/OIG, Phyllis K. Fong, Inspector General.

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