



## Office of Inspector General U.S. Small Business Administration

August 2004 Update

### *Agency Management*

Agency Completes 13 Final Actions on Audit of SBA's FY 2003 Financial Statement. The following final actions have been reported as completed:

1) Office of the Chief Financial Officer (OCFO) provided OIG with documentation of the Section 7(a) assumptions used in the FY 2004 reestimates; 2) the OCFO provided documentation that the SBIC program models are in accordance with Tech Release No. 3.; 3) OCFO analyzed and reconciled the 7(a) data used in the FY 2004 subsidy reestimates; 4) additional quality assurance steps will be included in the next reestimate cycle to ensure that the process and data are valid; 5) Small Business Investment Company (SBIC) subsidy models will use only loan accounting system (LMS) data; 6) OCFO has included data quality assurance materials in the Secondary Market Guarantee reestimates; 7) SBIC debenture and participating security models are now based on historical program experience except for near term defaults which were forecast by SBIC; 8) an internal control process has been formalized to include the standardized worksheets and notebooks which contain paper and electronic records of all models, assumptions, reestimate results, review results and approvals of materials; 9) all loan account balances will be reviewed as part of the credit subsidy process; 10) the Financial Reporting Information System general ledger and subsidy feeder are properly accounting for credit reform activities at the program and cohort levels; 11) OCFO has developed a plan to meet the November 15, 2004, reporting deadline; 12) OCFO reviewed all undelivered orders (UDOs) with disaster office and established two new reports that are automatically generated and circulated to support monthly reviews of outstanding UDOs; and 13) OCFO will continue to review obligation activity posted against expired funds in FY 2003, and maintain

sufficient documentation to ensure a clear audit trail during FY 2004.

Agency Completes Three Final Actions on Audit of SBA's FY 2003 Financial Statements – Management Letter. During the month of August, the following three final actions were reported as completed: 1) OCFO issued a procedural notice to program offices outlining the due date for performance data, documentation required to support reported performance data, procedures for describing limitations, and procedures for developing estimates if actual data are not available at fiscal year end; 2) OIG received documentation of the disaster model assumptions used in the FY 2004 reestimates; and 3) OIG received documentation of the Secondary Market Guarantee model assumption used in the FY 2004 reestimates.

### *Business Loan Programs*

Former Missouri Business President Pleads Guilty. On July 30, 2004, a former president of a business in Ozark, Missouri, pled guilty to **bank fraud, mail fraud, filing a false 1995 income tax return, and failure to appear** in Federal court. A joint investigation with Internal Revenue Service (IRS) Criminal Investigations determined that the former president made false statements to two Missouri financial institutions in order to obtain a \$340,000 SBA guaranteed loan. In the application, he failed to disclose numerous personal and corporate liabilities and also submitted a false 1994 income tax return which inflated his personal adjusted gross income (when compared to what he reported to the IRS) by \$100,000. Later, he defaulted on the loan, resulting in a principal loss of \$224,370. The investigation further determined that he bilked investors out of about \$1,600,000. The former president committed **mail fraud** in furtherance of this scheme, in which he induced more than 10 individuals to invest money with him through a marketing company, by

falsely claiming that the marketing company was engaged in the business of factoring accounts receivable in the trucking industry. The IRS investigation determined that he filed a false 1995 tax return, which failed to disclose income of about \$163,000. This investigation was initiated based on a referral from the SBA Branch Office, Springfield, Missouri.

#### OIG Issues Two Reports on Early Defaulted Loans.

On August 10, 2004, the OIG issued a final audit report on a \$1,100,000 SBA defaulted loan. The lender did not follow SBA guidance and prudent lending practices when it approved the guaranteed loan to an ineligible borrower. The borrower's credit history included delinquent Federal, state, and county taxes, and a lack of credit worthiness that included a history of lawsuits, judgments, and slow payments. As a result, SBA paid \$740,000 to honor the guaranty. OIG made one recommendation for full recovery. SBA Management requested additional information from the lender prior to addressing the recommendation. The second report was issued on August 24, 2004, and it revealed that the lender did not recalculate the borrower's repayment ability after the loan was restructured in a manner that adversely affected the borrower's cash flow. Therefore, the lender was unaware that the borrower lacked repayment ability after restructuring the loan. The lender also disbursed loan proceeds to pay a debt that did not qualify for refinancing. As a result, SBA made an erroneous payment when it honored the loan guaranty. OIG recommended that the Associate Administrator for Financial Assistance seek recovery of \$83,576, less any prior recoveries. SBA management agreed to recover the \$19,040 disbursed to refinance an ineligible debt, but disagreed with the finding that the borrower did not have repayment ability. SBA agreed with the lender's claim that repayment ability was based on projected sales even though the loan officer's report clearly stated that repayment ability was based on historical information. While admitting that there may have been additional steps the lender could have taken while reviewing the loan application, SBA management did not agree that the lender's loan origination was negligent. After further discussions, SBA management agreed to request that the Office of General Counsel (OGC) review the loan file. OIG will review the results of OGC's review during the audit follow-up process.

OIG Issues Report on a Survey of Risk Management by Industry Code. On August 11, 2004, the OIG issued a final report on a Survey of Risk Management by Industry Code. At the time of our review, SBA did not have procedures in place to routinely identify and control the level of financial risk by industry code. Subsequent to our review, the Office of Lender Oversight (OLO) incorporated industry code analysis in its oversight activities. A monthly portfolio analysis report is prepared with tables and charts of data by industry groups and includes data on concentrations and performance metrics by industry. Also, the redesigned risk-based review process for on-site examinations includes an analysis of industry concentrations in the lender's portfolio. SBA personnel could not provide evidence that they routinely identified and analyzed financial risk by industry code. Analyzing dollars at risk by industry codes is an appropriate tool that SBA should use to identify trends and potential problem areas deserving management's review.

#### Texas Man Indicted for False Claim of US Citizenship.

A Houston, Texas, man was charged in a superceding indictment on August 19, 2004, for **false claim of U.S. citizenship**. The Texas man received a \$420,000 SBA guaranteed loan. During the loan process, he provided a signed resume on which he falsely claimed US citizenship. The Department of Homeland Security (DHS) records indicate that the Texas man is, in fact, in the United States illegally. However, the SBA Form 912 was processed unsigned. The OIG is conducting this continuing investigation jointly with the DHS, Harris County Organized Crime Task Force, the Social Security Administration (SSA), and the Texas Alcoholic Beverage Commission (TABC).

Texas Men Charged In An 11 Count Indictment. Four Texas men were charged in an 11 count indictment on August 25, 2004. Specifically, they were charged with **conspiracy, bank fraud, money laundering, and forfeiture allegations**. All charges were for falsely obtaining nine "Speed Track" convenience store SBA guaranteed loans totaling \$9,500,000. The conspiracy count alleged that the Texas men recruited individuals to apply for SBA guaranteed loans; submitted false and fraudulent documents; artificially inflated certain checking account deposits; submitted false and fraudulent "gift letters"; and used escrowed loan proceeds to purchase cashiers checks that were used as down payments for loans to conceal the fact that the down payments were funded by the loan proceeds. The

**conspiracy** also alleged that one of the individuals used his special skill and his position in a manner that significantly facilitated the commission or concealment of the scheme and conspiracy to defraud a financial institution. The **forfeiture allegation** count specifies that the charged individuals shall forfeit to the U.S. any property, real or personal, constituting or derived from, proceeds obtained directly or indirectly as a result of the offenses alleged in counts two through ten of the indictment, totaling \$9,975,000. SBA OIG conducted this investigation jointly with the FBI.

#### Texas Man Indicted For Making A False Statement.

An Arlington, Texas, man was indicted on August 26, 2004, by the State of Texas, Collin County District Attorney's Office, for **making a false statement or false representation** on a sworn renewal application for a TABC permit. The Texas man made false claims of being a US citizen on his renewal application, and also on the SBA Form 912 when applying for an SBA guaranteed loan. SBA OIG is conducting this continuing investigation jointly with the DHS, SSA, Department of Agriculture, Texas Department of Public Safety, and TABC.

#### OIG Issues Management Advisory Report on the National Guaranty Purchase Center.

On August 31, 2004, the OIG issued a management advisory report on a review of the transfer of operations to the National Guaranty Purchase Center (Center). The review found that the Center was established without a thorough analysis of how best to accomplish centralization (including staffing, control, and accountability of files) of guaranty purchase and liquidation actions. Further, the OIG found that production reports were inadequate and unverifiable. Other areas of concern were noted, including the lack of a Center representative on the Center's Oversight Council and a questionable practice of recording lender purchase request withdrawals as "paid in full" in the Loan Accounting System. OIG made 11 recommendations to correct the identified staffing, file control, and reporting deficiencies, as well as the other noted areas of concern. The Associate Deputy Administrator for Capital Access (ADA/CA) and the Chief Operating Officer (COO) provided responses to the draft report. The ADA/CA took exception with some of the specific conclusions in the report, but agreed with six of the nine recommendations addressed to him. The ADA/CA did not provide

evidence to support his positions and, accordingly, only minor modifications were made to the report. Based on the ADA/CA's comments, OIG revised two recommendations. The ADA/CA's response to the other recommendation was unsupported and accordingly, the recommendation remained unchanged. The COO concurred with the recommendation addressed to him.

#### Agency Completes Final Action on Audit of Preferred Lender Program (PLP) Oversight Process.

In the audit, OIG recommended that the Office of Financial Assistance (OFA) revise the Lender Evaluation Worksheet scoring to ensure that lenders, who scored less than 75 percent of the points available for performance benchmarks could not achieve a passing score. OFA advised OIG that it incorporated its Loan Monitoring System data into the PLP approval and renewal process by using this information to determine whether a lender is on the list of high risk lenders, and to see if a lender has had a compliance review.

#### Agency Completes a Final Action on Audit of Borrowers with Prior Defaulted Loans.

As a result of the audit, OFA advised OIG that it has developed and implemented a database to check applicants against delinquent debtors.

## *Disaster Loan Program*

SBA's Office of Disaster Assistance Cancels Loan. On August 9, 2004, SBA's Office of Disaster Assistance (ODA) cancelled a \$19,400 disaster loan to a sea tow company. The cancellation resulted from information received from the U.S. Coast Guard revealing that the applicant was operating his tow vessel with a bogus captain's license. Actions taken by the U.S. Coast Guard will prevent the applicant from operating his business. The bogus license information was provided by OIG to SBA's ODA. This investigation was initiated based on a June 2, 2004, request for assistance from the U.S. Coast Guard.

## *Government Contracting and Business Development Programs*

Colorado Section 8(a) Business Owner Sentenced. On

August 20, 2004, the owner of a business in Englewood, Colorado, was sentenced to 24 months incarceration, 2 years supervised released, and a \$6,000 fine, and was ordered to pay \$39,197 in restitution. The business owner previously pled guilty to one count of **concealing assets** from the bankruptcy court, one count of **money laundering**, and one count of **criminal forfeiture**. The SBA OIG joint investigation with IRS, FBI, and DCIS disclosed that the business was a certified SBA Section 8(a) company that sold computer equipment to the U.S. Government and was primarily controlled by a non-minority. The owner, while an officer of the company, declared personal bankruptcy and received a discharge of approximately \$135,000 in debts. The owner directed three company employees to divert approximately \$690,000 of his business income to several bogus companies, which he created in order to avoid paying creditors. The owner failed to disclose his income and control of the company to the bankruptcy court and SBA. The investigation also disclosed that the owner hid other assets, including a Mercedes 400 SEL, Chevrolet Tahoe, and a personal residence. This case was initiated based on a call from a former employee to the Denver SBA OIG office.

Agency Completes Three Final Actions on Audit of Section 7(j) Management and Technical Assistance Program Cooperative Agreement Administration Activities. The following three final actions have been reported as completed: 1) the Office of Government Contract and Business Development recently issued an SOP chapter regarding unsolicited proposals; to ensure that cooperative agreements and grants are solicited to allow for proper planning for program delivery, timely, processing of applications, and awards without conditions; 2) SOP 80 05 03 addresses OIG's recommendation regarding proper documentation of proposal reviews; and 3) the SOP also addresses OIG's recommendation regarding proper monitoring of the performance of the Section 7(j) awardee-recipient, so that performance reports adhere to all notice of award requirements.

Agency Completes Final Action on Inspection and Evaluation Report on SBA's Federal and State Technology Partnership Program (FAST). OIG recommended that SBA implement the enforcement provisions under its authority as prescribed in OMB

Circular A-110 and terminate a particular FY 2001 award. A request to deobligate the subject award was transmitted to OPGM. On July 20, 2004, the award was modified and deobligated by the assigned grant officer.

This monthly update is produced by the SBA OIG, Harold Damelin, Inspector General.

The OIG has established an e-mail address ([oig@sba.gov](mailto:oig@sba.gov)) that we encourage the public to use to communicate with our office. We welcome your comments concerning this update or other OIG publications. To obtain copies of such documents please contact:

Teresa Clouser, SBA/OIG  
409 Third Street SW., 7<sup>th</sup> Floor  
Washington, DC 20416  
e-mail: [OIG@SBA.GOV](mailto:OIG@SBA.GOV)  
Telephone number (202) 205-6580  
FAX number (202) 205-7382

Many audit and inspection reports can be found on the Internet at

<http://www.sba.gov/IG/igreadingroom.html>

If you are aware of suspected waste, fraud, or abuse in any SBA program, please call the:

**OIG FRAUD LINE at (202) 205-7151**  
or  
**TOLL-FREE FRAUD LINE (800) 767-0385**