Office of Inspector General
U.S. Small Business Administration

January 2004 Update

Agency Management

The OIG Issues an Audit Report on Cosponsorship Activities. On January 20, 2004, the OIG issued a final report, "Audit of Puerto Rico & Virgin Island District Office (PRVIDO) Cosponsored and SBA-Sponsored Activities." The object of the audit was to determine whether the district operated in compliance with SBA policies and procedures and Federal law concerning SBA-sponsored and co-sponsored activities.

The OIG determined that the district's cosponsored activities and its Business Resource Center (BRC) were not operating in compliance with SBA policies and procedures and Federal law. We identified problems with: the approval and preparation of cosponsorship agreements for the district and the BRC; solicitation, acceptance, and disposition of gift funds; the manner in which fees were charged; use of cosponsor contributions and planned use of Economy Act funds; procurement activities of the district and BRC; counseling services provided at the BRC; and recordkeeping, reporting, and asset accountability of the district and BRC.

The aforementioned conditions occurred because: (a) district office personnel did not follow existing guidance; (b) there was insufficient oversight by regional and headquarters personnel; and (c) formal operating procedures did not thoroughly address cosponsorship operations and funds management.

We provided 11 recommendations to the Associate Administrator for Field Operations and the Associate Administrator for Strategic Alliances, addressing: funds solicitation, acceptance, use, and disposition; procurement requirements; fee charging; the return of unused Economy Act funds; BRC counseling activity; and timely reporting by the district. The Associate Administrators agreed with two recommendations, disagreed with two, and neither agreed nor disagreed with seven. In addition, SBA management stated that the report's language needed clarification, and that some issues had insufficient details to know if the conclusions were warranted. As a result of management's comments, portions of the report were modified or deleted. The disagreements and responses that were neither agreements nor disagreements will be addressed during the audit report resolution process.

The OIG Issues an Audit Report on SBA Purchase Cards. On January 26, 2004, the OIG issued an audit on the "Review of SBA Purchase Cards." The objective of the audit was to determine if SBA purchase card holders made any improper or potentially fraudulent purchases. The audit identified five purchases over $2,500 that did not comply with terms of the Federal Acquisition Regulation (FAR). These purchases were split into multiple charges to keep each charge under the $2,500 micro-purchase threshold, thus circumventing FAR requirements to set aside acquisitions over $2,500 for competition among small businesses.

Additionally, the auditors found several weaknesses in the program's internal controls. Forty-two requisition forms were unsigned by the approving official, more than half of the cardholder statements examined did not have the approving official's certification, and four cardholder accounts remained open after the cardholders separated from service with SBA. The audit did not find any purchases made after these employees separated. Lastly, the auditors didn't find any fraudulent transactions.

The OIG made two recommendations to the Director, Office of Procurement and Grants Management, to correct the deficiencies identified in the report. The Director agreed with both recommendations.

The OIG Issues Audit Report on SBA's FY 2003 Financial Statements. On January 30, 2004, the OIG issued Cotton and Company's Audit Report for SBA's FY 2003 Financial Statements, which disclaimed an opinion on both the FY 2003 financial statements and the restated FY 2002 financial statements. The auditors noted that the scope of their examination was limited because SBA was late in completing development and testing of certain credit program subsidy models, completing its credit program subsidy reestimates, and preparing its financial statements. As a result, the auditors were unable to apply all necessary auditing procedures or dispose of reservations identified during their work, which prevented them from expressing an opinion on the financial statements.

The audit disclosed three reportable conditions, two of which the auditors deemed to be material weaknesses. The two material weaknesses noted by the auditors were in the following areas: (1) SBA's credit reform controls, (2) SBA's financial management and reporting controls. The remaining reportable condition was SBA's information system controls continue to contain areas for improvement.

In addition, the auditors disclosed that SBA was not in substantial compliance with the Federal Financial Management Improvement Act (FFMIA) because (1) SBA's financial management systems did not substantially comply with FFMIA, (2) SBA is not in substantial compliance with Federal accounting standards, and (3) SBA is not in substantial compliance with the United States Standard General Ledger at the transaction level. The auditors also noted instances of noncompliance with the Prompt Pay Act and noted limitations on the scope of their examination which prevented them from completing their testing of SBA's compliance with the Antideficiency Act.

In response to the report, the Chief Financial Officer generally agreed with the auditor's findings and recommendations. He acknowledged that SBA did not meet key milestone dates for completing its budgeting and accounting work for certain credit programs and preparing its financial statements. He further acknowledged that he accepts responsibility for not providing sufficient time for the auditor to complete its work.

Final Action Completed on Compliance with the Financial Accounting Standards Board (FASB) Reporting Requirements. In the audit report, Audit of Selected Aspects of the Service Corps of Retired Executives Program (SCORE), the OIG recommended that the Acting Associate Administrator for the Office of Business and Community Initiatives, in conjunction with the Assistant Administrator for Administration, work with the National SCORE Office to ensure compliance with the FASB reporting requirements. As a result, the National SCORE Association will have its independent auditors produce its audited financial statements in accordance with relevant FASB requirements, including the reporting of chapter program income, assets and any liabilities. This language has also been included in the goals of the SCORE technical proposal for FY 04 and will become part of the Cooperative Agreement.

Final Action Completed on SBA Information System Controls Audit. In the audit report, SBA Information Systems Controls FY 2002, the OIG recommended that the Chief Human Capital Officer review duties and eliminate excessive access granted to the NFC payroll/personnel system. We also recommended that Office of Human Capital Management (OHCM) review its current security profiles and reduce the number of profiles commensurate to job responsibilities. As a result, the OHCM reduced the number of access profiles by five.

Final Action Completed on SBA Information System Controls Audit. In the audit report, SBA Information Systems Control – FY 2001, the OIG recommended that the Chief Information Officer, in conjunction with the appropriate program offices, develop and test disaster recovery and business contingency plans on an annual basis. As a result, the Agency provided the OIG with results of Disaster Recovery Plan tests from March 2003 (Mainframe and JAAMS) and September 2003 (Sybase Applications).

Business Loan Program

Pennsylvania Man Found Guilty On All Counts. The owner of a business in Lancaster, Pennsylvania, was found guilty by a jury on January 9, 2004, on three counts of **mail fraud** and three counts of **making false statements** to the SBA. The owner obtained a $315,000 SBA guaranteed loan in 1990. The loan went into default in 1991. The owner made various offers of compromise to SBA during the period 1992-1995, stating that the only payment he could make to SBA was $60,000, which he stated was the amount of equity in his home. The owner was found guilty of a scheme to conceal $551,000 from SBA that he had obtained through an unrelated stock sale. In carrying out the fraud scheme, he opened various bank accounts in the names of his children and prepared bogus stock certificates showing that his children and other entities actually owned the stock totaling $551,000. The jury found that he had complete control of the shares of stock and monies from the stock sale and that he purchased a warehouse for $475,000 in 1994, and concealed this from SBA. He was also found guilty of submitting false financial information and stock certificates to SBA by United States Postal Service and Federal Express. The purpose of the scheme was to induce SBA to accept $60,000 and forgive the remaining balance of the loan, which is estimated to be $437,000. A sentencing date has not been set. This case was initiated based on a referral from SBA's Philadelphia District Office.

Former Norfolk Virginia Businessman Sentenced. A former Norfolk, Virginia, businessman and initial director of a management corporation was sentenced on January 14, 2004. The Judge sentenced him to serve 6 months in prison and 3 years supervised release after completing his term. The former businessman was ordered to pay restitution of $673,646 to SBA and $1,252,779 to a financial institution, and to pay a special assessment of $100. The former businessman was previously charged in **an Information** filed on August 19, 2003, with one count of **conspiracy to commit wire fraud.** The **conspiracy** count related to conspiring to inflate the purchase price of the management corporation's properties by $1,148,000 to fraudulently obtain loan proceeds from two financial institutions. He conspired to inflate the purchase price by engaging in a scheme to have the management corporation pay $550,000 from the loan proceeds to another company owned by him for repairs that were not to be done. He also conspired to pay $200,000 each to the stockholders of the management corporation and disburse $198,000 of the loan proceeds to purchase another motel. The former businessman further conspired to submit false statements to the two financial institutions by submitting false information regarding the assets and liabilities of the shareholders of the management corporation. He accomplished this by falsely stating that he was giving a combined gift of $825,000 to the two shareholders of the management corporation to be used as capital injection, knowing that it was not a gift and that it had to be paid back to him from the loan proceeds. Through the above scheme, he caused one of the financial institutions to wire loan funds in the amount of $2,270,000 and the other financial institution to wire loan funds in the amount of $996,230 to the management corporation. This is an on-going joint investigation with the Federal Bureau of Investigations (FBI).

The OIG Issues an Audit Report on an Early Defaulted Loan. On January 8, 2004, the OIG issued a final report of an early defaulted SBA guaranteed loan. The report found that the lender made a material error in assessing the borrower's repayment ability, which led to an incorrect conclusion regarding cash flow. As a result, the lender made a loan to a borrower that did not have repayment ability. The borrower defaulted on the loan after only one payment, resulting in an SBA erroneous payment of $777,516 when it purchased the guaranty. The borrower projected gasoline sales of $3.4 million during the first year of operation. Based on the total amount of unmet demand within the trade area, per a market analysis performed by a third party, and the national price for gasoline at the time of approval, the borrower's maximum annual sales could be only $275,300, or 92 percent less than projected sales. To meet projected sales of $3.4 million, the borrower would have had to sell 11 times the available unmet demand for gasoline in the trade area. The OIG recommended that the Dallas/Fort Worth District Office seek recovery of $777,516, less any subsequent recoveries, from the lender on the guaranty paid for the loan. The district office agreed with the recommendation and requested that the lender repay the guaranty amount.

Small Business Lending Company Issues Refund to SBA. On January 14, 2004, SBA received its previously paid guaranty totaling $316,965.37, regarding a loan made in 2000 to a business in Independence, Missouri. This $405,000 SBA-guaranteed loan went into default almost immediately. The OIG investigation determined that the corporate president, 20 percent owner of the business, guarantor, and convenience store manager, was an illegal alien when this loan was made, having overstayed his 6 month visitor visa since January 1995. The corporate president indicated on his SBA Form 912 that he was not a citizen of the US, but he provided no further information regarding his immigration status. Internal lender documents showed that the lender was aware of this and needed to verify his immigration status. This verification was apparently never done, but the lender still certified on its PLP application that the "Principals of business are citizens of the U.S. citizens or resident aliens… or capable and consistent management has been assured." After the OIG contacted the lender and informed them of his immigration status, and requested copies of any and all records regarding this loan, the lender informed SBA that it was canceling and refunding the guaranty. The Assistant U.S. Attorney in Kansas City, Missouri, was informed of the facts in this case. Since SBA has now suffered no loss, the AUSA stated that his office would decline criminal prosecution. The corporate president remains at large. The OIG will provide its findings to the Bureau of Customs and Immigration Enforcement. This investigation was conducted under the SBA-OIG Citizenship Project.

Government Contracting and Business Development Programs

The OIG Issues Inspection Report on the FAST Program. On December 30, 2003, the OIG issued a statutorily mandated report on SBA's Federal and State Technology Partnership (FAST) program. The purpose of the FAST program is to strengthen the technological competitiveness of small business concerns in the States by ensuring their participation in Federal research and development. The inspection report assessed the extent to which recipients under the FAST program have developed and are utilizing effective performance indicators by which to measure the results of their program activities. Observations were also made regarding the overall management and effectiveness of the FAST program. The OIG recommended that SBA refine its guidance to program participants regarding developing performance measures and take the lead in an effort to establish a core set of measures. We also recommended that SBA vigorously enforce its reporting requirements and take action against grantees who do not comply. The Agency agreed with all of OIG's recommendations.

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

The OIG has established an e-mail address (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:

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