



Office of Inspector General U.S. Small Business Administration

June 2004 Update

Agency Management

Agency Completes Three Final Actions on Audit of SBA's FY 2003 Financial Statements. As a result of the audit of the SBA's FY 2003 Financial Statements, the Office of the Chief Financial Officer (OCFO) has established a Loan Team, which includes both budget and accounting team personnel. The team meets regularly to work through significant loan program budget and accounting issues. The OCFO also added specific transactions to SBIC processing beginning in FY 2004. The OCFO already accounts for SBIC transactions based on Investment Division instructions. The OCFO will work to reconcile program office records with SBIC accounting records at the cohort and activity year level for prior year and current activity. Once this is completed, SBIC subsidy modeling will use Loan Accounting System historical data in the future, except that program data may be used for projections of defaults and recoveries. The OCFO will also review the Financial Reporting Information System transactions and account balances at the fund level to identify anomalies and research solutions. The OCFO will also research Management Accounting Reporting System Loan System transactions and balances to identify anomalies and conduct corrective action.

Agency Completes Final Action on Supplemental Report Related to Cotton & Company's Agreed-upon Procedures Report on Sensitive Payments. On June 2, 2004, SBA Procedural Notice 2000-676, Personal and Indirect Travel, was issued to complete the final action on OIG's recommendation that the CFO implement policies and procedures that:

- (1) specify when it is appropriate for employees to originate and/or terminate travel from other than their official duty station for official government travel;
- (2) require authorizing officials to attach written justification to the travel voucher when an employee is

authorized to initiate or terminate travel from a location other than their official duty station; and

- (3) prohibit individuals from self authorizing travel that originates and/or terminates from a location other than their official duty station.

Business Loan Programs

Florida Man Pleads Guilty to Conspiracy. On June 10, 2004, a Palm Coast, Florida, man pled guilty to one count of **conspiracy to commit false statements** pursuant to an Information. The guilty plea relates to a \$560,000 SBA guaranteed loan that was obtained by the owner of a New Jersey automotive repair business to purchase land. The investigation revealed that the business owner did not make the capital injection, and conspired with the property owner to represent to the lender that the capital injection had been made. They entered into an \$80,000 mortgage agreement, which they concealed from the lender, in lieu of the capital injection. The business owner also obtained a second loan to purchase land from the property owner. The second loan was also obtained under fraudulent pretenses. The business owner and the property owner are cooperating in the investigation. This case was initiated based on a referral from the lender.

Texas Man Pleads Guilty to Conspiracy. A Houston, Texas, man pled guilty on June 10, 2004, in the Southern District of Texas, to one count of **conspiracy to commit wire fraud and bank fraud** and two counts of **bank fraud** in connection with a fraudulent scheme involving at least \$28 million in loans guaranteed by the SBA. The Texas man admitted that for a 2 year period beginning July 1997, he brokered loans to individuals interested in purchasing convenience stores. He solicited these potential buyers through advertisements in Pakistani language newspapers and caused these individuals to sign documents related to their loan applications that he knew were false. He submitted

these false documents to the lenders. He also provided cashier's checks at the closing of some of these loans to make it appear that the buyers had made capital injections or down payments, as required by SBA and the lenders, when, in fact, they had not. This investigation was initiated based on a referral from the Houston District Office. The SBA OIG conducted this investigation jointly with the Federal Bureau of Investigation (FBI).

Eight Texas Convenience Store Owners Indicted.

Eight SBA loan recipients were indicted by the State of Texas, Tarrant County, District Attorney's Office, Fort Worth, Texas. These individuals were charged with **making a false statement or false representation** on a sworn renewal application for a Texas Alcoholic Beverage Commission permit, claiming to be United States citizens when, in fact, they were not. False citizenship representations were also made on their SBA loan applications. The SBA OIG is continuing to conduct the investigation as a joint effort with the Department of Homeland Security, Social Security Administration, Department of Agriculture, Texas Department of Public Safety, and the Texas Alcoholic Beverage Commission.

OIG Issues Final Audit Report on SBA Guaranteed Loan.

On June 22, 2004, a final report on an audit of an SBA Guaranteed Loan was issued to the Assistant Administrator for Financial Assistance (AA/FA). The lender made a Preferred Lender Program (PLP) loan to a borrower with full knowledge that the president of the company had a criminal history. The lender also did not properly verify equity injection or resolve questionable character issues. The SBA requirements state that a loan is ineligible for PLP origination and must be processed under regular 7(a) procedures when an officer answers "yes" to any criminal history questions on SBA Form 912. Additionally, the borrower did not have sufficient documentation to support the required equity injection, and a character issue of unpaid payroll taxes was not given proper consideration during loan origination. As a result, SBA made an improper payment when it honored the guaranty. We made one recommendation to the AA/FA and management agreed with our recommendation.

OIG Issues Audit Report on Early Defaulted Loan.

On June 22, 2004, the OIG issued a final report on an early defaulted loan. The audit disclosed that the

lender did not use prudent lending procedures to process a Section 7(a) loan to the borrower and failed to verify the borrower's residency status, as required, when a borrower is identified as a non-U.S. citizen. The lender also did not conduct a complete eligibility review to include an evaluation of the sufficiency and source of capital injections in their analysis. In addition, financial information submitted by the seller of the business was not validated. As a result, SBA made an improper payment when honoring the lender's request for payment on the guaranty.

Houston District Office Declines Loan Application. On June 29, 2004, SBA's Houston District Office declined participation on a 7(a) loan application to partially finance a \$2.55 million sale of an existing gas station in Montgomery County, Texas. The loan application was referred to the OIG after suspicions were raised by an unusually high sales price shown on the purchase contract. The gas station purchase was to be financed with a \$1,000,000 piggyback loan in a first lien position; a \$1,000,000 SBA 7(a) guaranteed loan from the same lender in a secondary lien position; a capital contribution from the applicant; and a standby loan from the seller in a third lien position. An OIG review revealed that the sellers of the gas station did not disclose two separate outstanding SBA guaranteed loans on the same business. It was further determined that one of the sellers' loans was being liquidated by another SBA lender at a substantially lower value. With the assistance of OIG's analysis, SBA declined the \$2,000,000 loan request.

Disaster Loan Program

New York Doctor Pleads Guilty. On June 2, 2004, a New York, NY, doctor pled guilty to two misdemeanor counts of **fraudulently demanding or endeavoring to obtain money from the United States**. The doctor was originally indicted on September 5, 2002, on three felony counts of **false statements** and one count of **conspiracy** in connection with applications she made in her name, on behalf of her mother, with the Federal Emergency Management Agency and the SBA for disaster relief funding pursuant to Hurricane Floyd. The hurricane allegedly damaged her mother's home. A superseding indictment on April 29, 2004, charged the doctor with three felony counts of **making false statements** in connection with her loan. In September of 1999, the doctor applied for a business disaster loan from the SBA in her name for her medical practice,

requesting a loan in the amount of \$319,056 for economic injury and physical damage caused by the hurricane. She claimed approximately \$70,000 worth of medical equipment stored in her residence was destroyed in the storm along with the home. She also claimed that she had opened a practice in Cold Springs, NY and submitted a lease to that effect. The doctor was approved for an \$88,400 loan, of which she only received \$10,000 due to her inability to keep the scheme going. The investigation revealed that there never was any medical equipment stored in the house, and that the major item, a \$50,000 anesthesia machine, was damaged while it was being shipped from the doctor's office in California to her office in New York City weeks before the hurricane. The bill of lading revealed that other items of equipment were also shipped to the doctor's New York City office. Further, the lease she submitted for the office in Cold Springs, NY was false. This case was initiated based on a referral from a private individual. The SBA OIG is - conducting this investigation jointly with the FBI.

Government Contracting and Business Development Programs

OIG Issues Business Development Report. On June 2, 2004, the OIG issued a report on the business development services provided by the 8(a) Business Development Program. The objectives of the audit were to: (1) determine the nature and extent of business development services being provided to program participants; and (2) follow up on past audit recommendations related to the 8(a) program. The OIG determined that SBA had not established criteria for delivering and measuring business development services. The OIG found that SBA's district offices and resource partners provided various types of business development assistance to 8(a) firms, but the effort was neither tracked nor strategically managed. The OIG made two recommendations in the report. The Acting Associate Administrator for Business Development agreed with the report and discussed actions and timeframes for implementing the two recommendations.

OIG Issues Audit Report on San Francisco District Office Administrative Activities. On June 30, 2004, the OIG issued the final audit report on San Francisco District Office Administrative Activities Related to the Silicon Valley Small Business Development Center

(SVSBDC). The audit found that \$57,645 of program income for the SVSBDC was inappropriately collected, commingled with unrelated funds, and disbursed by the San Jose Service Core of Retired Executives (SCORE) office. In addition, \$225,000 was paid for contractor services that were not acquired in accordance with established guidelines. These conditions occurred because an official in the San Francisco District Office: (1) improperly implemented procedures which resulted in SVSBDC funds being handled contrary to SBDC Cooperative and co-sponsorship Agreements; and (2) influenced the sole-source selection of the SBDC-technical assistance program director in possible violation of ethics and employee standards of conduct rules. The OIG recommended that the Associate Administrator for Office of Field Operations (AA/OFO) (1) determine what, if any, disciplinary or other administrative actions should be taken against the official in the San Francisco District Office for developing a co-sponsorship policy memorandum that overrode the SBDC cooperative agreement, (2) and direct the San Francisco office to instruct the San Jose SCORE Chapter to return all SVSBDC program income that was generated at the E-Center and is being held in the E-Center Special Account to West Valley Community College. The AA/OFO has initiated a thorough review of the issues raised by the audit and will provide a comprehensive response to recommendation 1 within 30 days. In response to recommendation 2, program income has been returned to the SVSBDC.

Three Final Actions Completed on Audit of 7(j) Management and Technical Assistance Program Cooperative Agreement Administration Activities. As a result of the audit, the Agency has completed the following actions: (1) BD updated their Standard Operating Procedure (SOP), and it contains a section on unsolicited proposals and addresses adherence to applicable policies; (2) a review of SBA's internal guidance has taken place as part of the development of a new SOP, and the SOP incorporates a section on unsolicited proposals which ensures that (i) unsolicited proposals will only be considered if funds remain after the agency considers proposals submitted in response to competitive announcements, and (ii) the unsolicited proposals are supported by required justifications for noncompetitive procurements; and (4) ADA/GCBD issued written procedural guidance on the proper way of reviewing performance and financial reports in line with the Notice of Award. The SOP also incorporates a

section on the technical representatives' responsibilities for reviewing performance and financial reports in line with the Notice of Award.

This monthly update is produced by the SBA OIG,
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The OIG has established an e-mail address (oit@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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