



Office of Inspector General U.S. Small Business Administration

March/April 2009 Update

Recovery Oversight

OIG Issues Report on Key Unresolved Audit Recommendations Impacting the Recovery Act. To reduce risks associated with the extraordinary level of funding under the American Recovery and Reinvestment Act of 2009 (Recovery Act), the Office of Management and Budget (OMB) has directed agencies to address deficiencies disclosed by prior audits and investigations in program areas under which Recovery Act funds are authorized. Where recommended final actions have not been completed, agencies are required to either expedite implementation of the recommendations or explain in their risk mitigation plans why such actions cannot or should not be taken.

To assist SBA in this effort, the OIG issued a report that identified 29 unresolved audit recommendations related to (1) programs directly impacted by the Recovery Act and (2) operational support processes that will impact the disbursement and financial reporting of Recovery Act funds. Final actions were overdue for 10 of the 29 recommendations, and others either did not have a management decision or had identified final actions that should be expedited due to the associated risks. The recommendations address actions that are needed to (1) strengthen oversight of 7(a) lenders; (2) identify and recover improper payments; (3) develop procedures and performance measures for the Microloan program; (4) enhance IT systems used to monitor and manage loan activity; and (5) improve contract award and administration.

Business Loan Programs

OIG Issues Report on Liquidation of Certified Development Company (CDC) Loans. On March 30, 2009, the OIG issued an audit report on the *SBA-Serviced Liquidation of Certified Development Company Loans*. The objectives of the audit were to

determine whether (1) SBA's liquidation efforts maximized recoveries of outstanding balances on purchased CDC loans, and (2) centralization improved the liquidation process.

SBA's 504 Loan program provides small businesses with long-term, fixed-rate financing, in the form of government-guaranteed loans, for the purchase of land, buildings, machinery, and other fixed assets. These loans are issued through a partnership with CDC's and private sector third-party lenders and are funded through the issuance of government-guaranteed debentures. The CDC's are non-profit corporations that are certified and regulated by SBA to package, process, close, and service loans under the 504 program.

CDC loans that default are placed into liquidation when SBA purchases the debentures that guarantee the loans. In February 2007, SBA centralized CDC liquidations by shifting liquidation responsibilities from its district offices to two commercial loan service centers in California and Arkansas. The OIG reviewed a sample of 95 loans in liquidation as of July 29, 2007, having outstanding loan balances totaling \$29.3 million, and found that SBA did not maximize opportunities to recover \$12.7 million on 30 of the loans. Based on the sample results, the OIG estimated that SBA missed opportunities to collect at least \$106 million on the 1,427 loans in liquidation as of July 29, 2007, that had recorded purchase dates. Missed collection opportunities were attributed to deficiencies found in all of the key areas of the liquidation process.

Specifically, SBA did not:

- conduct adequate or timely protective bid analyses;
- obtain current appraisals;
- perfect liens;

- identify and pursue all available assets;
- attempt and reach compromises reflective of obligors' repayment ability;
- properly charge-off loans; or
- refer charged-off loans to Treasury.

The OIG also found that, in the first 6 months after centralization, there was no measurable improvement in the percentage of fully liquidated loans at the service centers because the two centers inherited a large number of incomplete loans files and focused resources on reducing a backlog of older loans awaiting charge-off; by April 2008, SBA had reduced the backlog from as high as 509 to 153. SBA has since re-engineered the liquidation process and increased staffing at the two centers. These improvements are expected to expedite referral of loans to Treasury for further debt collection. The Agency agreed with OIG's recommendation to evaluate whether these improvements have enabled the centers to complete all required liquidation actions and, if not, make appropriate staffing and process adjustments to do so.

Ongoing Investigation Results in Indictments. The following case is part of an ongoing investigation, being conducted jointly with the U.S. Secret Service (USSS), relating to a scheme in which a lender's former executive vice president and others conspired to fraudulently qualify loan applicants for SBA-guaranteed loans.

- On March 2, 2009, an Illinois gas station owner pled guilty to one count of making a false statement. The investigation disclosed that he was involved in a scheme to induce a lender to approve three separate loans (one SBA-guaranteed loan and two lender direct loans), totaling more than \$4 million, to purchase three gas stations in Iowa. The owner, along with a co-conspirator, enlisted "front" borrowers and provided the lender with false and fraudulent documentation on behalf of the borrowers in order to obtain approval of the three loans. The co-conspirator previously pled guilty in relation to this case and has also been charged in a separate indictment.

Motorcycle Shop Owner Pleads Guilty. On March 10, 2009, the owner of a Maryland motorcycle shop pled guilty to one count of making false statements to SBA. He obtained a \$120,000 SBA-guaranteed loan for his business through the Anne Arundel County

(Maryland) Economic Development Corporation. In support of the loan application, he submitted false documentation showing he had provided a cash injection of \$30,000.

Texas Businessman Sentenced. On March 20, 2009, the president of a Texas meat processing company was sentenced to 37 months in prison, 5 years supervised release, a \$10,000 fine, \$2,363,290.98 in restitution, and a \$600 special assessment fee. Between 2002 and 2005, he received \$1,236,500 in SBA-guaranteed loans and an additional \$1,712,000 in non-SBA loans. He used materially false and fraudulent representations and documents to convince numerous lenders that he had sufficient collateral and income to repay the amounts borrowed. The OIG is conducting this investigation jointly with the Federal Bureau of Investigation (FBI).

Missouri Woman Pleads Guilty. On March 20, 2009, a Missouri woman pled guilty to a superseding information charging her with making false statements to SBA in connection with a \$80,070 SBAExpress loan. The loan was made by a Missouri bank to a frozen custard restaurant in Amarillo, Texas, reportedly that she reportedly owned. The investigation determined that, although she indicated on the borrower information form that she had never been arrested, charged, or convicted of any crime other than a minor motor vehicle violation, she actually had four prior misdemeanor drug convictions and had been arrested and charged with passing bad checks. This case is being investigated jointly with the FBI.

Michigan Man Indicted. On April 14, 2009, a Michigan man was indicted on one count of false statements to the SBA in relation to an \$85,000 SBAExpress line of credit made by a Michigan bank in May 2005. Specifically, the indictment alleges he made false statements and representations that he was not under indictment, was on parole or probation, and had not been charged, arrested, or convicted for a criminal offense. In fact, he had been previously convicted in another SBA OIG case for making false statements to SBA and another Michigan lender about his criminal history in order to assume an SBA-guaranteed loan of about \$640,000 for a gas station and mini mart. He would not have been eligible for SBA financial assistance if his prior criminal history had been revealed to the SBA. The OIG is conducting this investigation jointly with the USSS.

Disaster Loan Program

OIG Issues Report on SBA's FY 2007 Improper Payment Rate for the Disaster Loan Program. On March 26, 2009, the OIG issued an audit report on the *SBA's FY 2007 Improper Payment Rate for the Disaster Loan Program*. The Improper Payments Information Act (IPIA) of 2002 requires federal agencies to review their programs and activities annually, identify programs that may be susceptible to significant improper payments, estimate amounts improperly paid, and report on the amounts of improper payments and actions to reduce them. Since implementation of the IPIA, SBA has reported a low improper payment rate for the Disaster Loan program; however, an OIG review disclosed that SBA's estimate for FY 2007 significantly understated the level of improper payments and was not statistically valid. SBA reported that improper payments were about \$4.5 million, or 0.55 percent of the \$819.7 million in loans approved in FY 2007. In contrast, the OIG estimated the improper payment rate to be at least 46 percent, or approximately \$1.5 billion of \$3.4 billion in loans disbursed in FY 2007.

SBA did not properly estimate the rate because of major sampling design errors, flaws in measurement methodology, and inadequate reviews of loan files. In preparing its estimate, the Agency employed attribute sampling, when it should have used variable sampling. The Agency also did not properly calculate the error rate or apply it when projecting the total value of FY 2007 improper payments because it did not consult with a statistician, as required by Office of Management and Budget (OMB) guidance. In addition, SBA's improper payment reviews did not adequately detect significant errors during loan origination and disbursement. The OIG's review of 30 of the 210 loans sampled by SBA revealed nine improper payments, whereas the Agency had only identified two. Finally, loan reviewers did not have clear instructions regarding what constituted improper payments.

The OIG made seven recommendations to address the identified deficiencies. The Agency generally concurred with the recommendations, but commented on several issues raised in the report. ODA disagreed with OIG's assertion that, to be accurate, improper payment reviews must be based on disbursements rather than approvals, but agreed to revisit the issue with OMB to obtain clear guidance for the Disaster

Loan program. ODA also responded that payments involving a borrower's lack of repayment ability or creditworthiness should not be considered improper because the Agency's policy in effect at the time allowed such payments. The OIG contended that loans to borrowers lacking repayment ability constituted improper payments despite the approval process followed and ultimately conflicted with the intent of the IPIA. The Agency promised to work with OMB to clarify guidance and ensure issuance of appropriate disclosures for previously reported improper payment rates.

OIG Issues Report on Borrower Eligibility for Gulf Coast Disaster Loans. On March 31, 2009 the OIG issued an audit report on *Borrower Eligibility for Gulf Coast Disaster Loans*. The objective of the audit was to determine if ODA had adequate controls in place to prevent ineligible applicants from receiving disaster loans for properties that were not their primary residences.

The OIG reviewed a sample of 35 loans disbursed between October 2005 and October 2008 and found that 29 loans, or 83 percent, were approved by ODA without adequately verifying whether the properties were the primary residences of the applicants. In addition, ODA did not obtain proof of ownership for one loan applicant. Further review determined that for 8 of the 29 loans, on which ODA disbursed \$683,200, the properties may not have been the applicants' primary residences. Another borrower received a Housing and Urban Development (HUD) Road Home Grant for approximately \$19,000 after receiving an SBA disaster loan, resulting in a duplicate benefit. The OIG made two recommendations to address weaknesses associated with identifying borrowers' primary residences, and a third recommendation that ODA request remittance from HUD for the Road Home Grant that duplicated disaster benefits awarded under the SBA loan.

Mississippi Man Pleads Guilty. On April 6, 2009, a Mississippi man pled guilty to one count of false statements and two counts of theft of government funds. He was previously indicted for making false statements on his claims for disaster benefits after Hurricane Katrina. Specifically, he indicated that his primary residence was in an area affected by the storm when, in fact, he resided in an area that was not affected. He fraudulently received \$179,400 from the SBA and \$14,006 from the Federal Emergency

Management Agency (FEMA). He also applied for a Mississippi Development Authority Homeowner Assistance Program Grant, which was suspended pending the results of the investigation. The SBA OIG is investigating this case jointly with the Department of Homeland Security OIG, Department of Housing and Urban Development OIG, and the Mississippi State Auditor's Office.

New York Couple Settle Case. On April 9, 2009, the U.S. Attorney's Office for the Southern District of New York filed a Stipulation and Order of Settlement and Dismissal in a civil case against the president and sole shareholder of a fabric company; his wife, the president of a clothing company; and the clothing company (hereafter known as the defendants). The defendants agreed to a judgment in the amount of \$1,074,800 to settle allegations that they made false statements in order to secure a \$537,400 SBA-guaranteed disaster loan and converted the proceeds from the SBA loan for their personal use. The investigation revealed that the president of the fabric company submitted false statements, namely that there were no lawsuits pending against him or his company. In reality, court documents indicated two lawsuits with judgments prior to the filing of the application for the SBA disaster loan. Further investigation revealed that he transferred loan proceeds to his wife's company in order to disburse thousands of dollars to himself and his wife.

Agency Management

OIG Issues Report on a Review of SBA's National Guaranty Purchase Center Furniture Contract. On March 31, 2009, the OIG issued an audit report on a *Review of SBA's National Guaranty Purchase Center Furniture Contract*. The OIG initiated the review in response to allegations that SBA made an advance payment for the purchase and installation of workstation furniture at its National Guaranty Purchase Center (NGPC) in Herndon, Virginia, that was not delivered. The OIG found that:

- The original award was inappropriately sole-sourced to a small business contractor. In addition, shortly thereafter, the contract was inappropriately modified, doubling the value of the original award.
- SBA violated federal regulations by (1) advancing a \$226,678 payment to the contractor prior to delivery of the furniture, and (2) making two

additional payments totaling \$78,856 that were unrelated to the contract.

- The Contracting Officer's Technical Representative inappropriately certified that the contractor should be paid and did not inform the contracting officer that the furniture had not been delivered. The contractor failed to use the advance to pay the vendor, resulting in repossession of the furniture.
- SBA inappropriately reduced the contractor's debt for the undelivered furniture based solely on unvalidated contractor invoices.
- The vice president of the contractor was also the owner of the subcontractor; therefore, the subcontractor may not have acted independently in repossessing the furniture.
- Two SBA contracting officers involved in the contract did not follow applicable rules or regulations. They signed documents without full knowledge of what they were approving and made decisions without informing superiors or requesting assistance from SBA's Office of General Counsel.

The OIG recommended that SBA establish controls to prevent inappropriate contract modifications; revise its SOP to require proof of delivery of goods and services with payment requests; determine whether \$239,030 in payments to the contractor were proper and, if not, seek reimbursement; and determine whether disciplinary actions should be taken against the SBA contracting officers who managed the contract. The Agency agreed with most of the recommendations, but planned further legal consultation before determining whether debarment action against the contractor was feasible, appropriate, and warranted.

This monthly update is produced by the SBA OIG,
Peter L. McClintock, Acting 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 these documents
please contact:

SBA OIG
409 Third Street SW., 7th Floor
Washington, DC 20416
E-mail: OIG@SBA.GOV
Telephone number (202) 205-6586
FAX number (202) 205-7382

Many OIG reports can be found
on the Internet at:

<http://www.sba.gov/ig>

If you are aware of suspected waste, fraud, or
abuse in any SBA program, please report it online at:

http://web.sba.gov/oigcss/client/dsp_welcome.cfm

Or call the OIG Hotline toll-free at (800) 767-0385