



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

November 2004 Update

### *Agency Management*

OIG Issues Report on SBA's FY 2004 Financial Statements. On November 15, 2004, OIG issued the independent auditor's report on SBA's Fiscal Year (FY) 2004 Financial Statements. The auditors issued an unqualified opinion on the FY 2004 combined statement of budgetary resources and the FY 2003 consolidated balance sheet (as restated), and issued a qualified opinion on the FY 2004 consolidated balance sheet and statements of net costs, changes in net position, and financing. The independent auditor was not engaged to apply all necessary auditing procedures to express an opinion on SBA's FY 2003 consolidated statements of net costs, changes in net position, financing, and the combined statement of budgetary resources, which previously received a disclaimed opinion. The auditors qualified their opinion because they were unable to satisfy themselves as to the reasonableness of:

- 1) SBA's FY 2004 subsidy re-estimates pertaining to its Section 7(a), 504, SBIC participating securities and debenture programs; 2) the value of Credit Program Receivables and Related Foreclosed Property; and 3) the value of Liabilities for Loan Guarantees for these four programs. The independent auditor's report on Internal Control discusses three matters considered reportable conditions: 1) Financial Management and Reporting Controls; 2) Credit Reform Controls; and 3) Agency-wide Information System Controls. The auditors considered the first two areas to be material weaknesses under the standards established by the American Institute of Certified Public Accountants and Office of Management and Budget Bulletin No. 01-02. The independent auditor's report on Compliance with Laws and Regulations disclosed that SBA was not in substantial compliance with the Federal Financial Management Improvement Act (FFMIA), and noted instances of noncompliance with the Anti-Deficiency Act and the Federal Credit Reform Act. SBA management generally agreed with the auditors' findings and recommendations and noted that meeting the accelerated reporting date of November 15<sup>th</sup> was a major

accomplishment. Management is generally pleased with the improvements in the audit opinion and believes it reflects a substantial improvement in the quality of the Agency's financial statements.

OIG Issues Fall 2004 Semiannual Report to Congress. The Office of Inspector General (OIG) issued its fall 2004 Semiannual Report to Congress. The report summarizes the results of the OIG's investigations, audits, and other activities during the period April 1, 2004, through September 30, 2004, and can be located at <http://www.sba.gov/IG/04fallsar.pdf>. During this 6-month period, we issued 27 reports with significant recommendations for improving Agency operations, reducing fraud and unnecessary losses, and recovering funds. OIG investigations led to 58 indictments and 17 convictions of subjects who defrauded the Federal Government. With a staff of about 100, the OIG continues to produce substantial savings and important program improvements. This reporting period has been one of continued transition for the Agency and the OIG. To improve our ability to address the rapid changes taking place in the Agency, the OIG responded to the recent centralization of the loan guaranty purchase and liquidation processes by assigning four of our audit staff to SBA's new National Guaranty Purchase Center (Center) in Herndon, Virginia. This move will enhance our ability to provide the Agency with timely information, observations, and recommendations on systemic issues. Further, our Investigations and Auditing Divisions have worked closely to identify significant fraud—especially in 9/11 disaster loans. We made significant strides in addressing fraud by borrowers who falsely claim to be United States citizens, and we continue to target loan agent fraud. We also issued reports focusing on a number of SBA's major management challenges, particularly in the areas of loan guaranty purchases, information security, financial management, and business development. While much remains to be done, SBA is making progress on a number of its challenges. Meanwhile, we continue to work closely with SBA to help resolve these issues.

Agency Completes Final Action on Audit of SBA's Controls over SSN's – PCIE Project. The following final action has been reported as being completed: the Office of Administration reviewed sample contracts to determine if they contained non-disclosure clauses. The review determined that, while security clearances were required for contractors, the non-disclosure clauses were not included. As a result, the Agency modified contracts that allow contractors access to sensitive data to include these clauses and is taking the necessary steps to ensure that these clauses are contained in future contracts.

## ***Business Loan Programs***

Proposed Debarment of Oregon Mortgage Loan Broker. In response to an OIG recommendation, SBA's Office of Lender Oversight issued a notice of proposed debarment to the former owner of a business and mortgage loan brokerage company in Oregon. The broker brought business loan applications to commercial lenders to obtain lines of credit and/or SBA-guaranteed business loans on behalf of his clients. An investigation by the Federal Bureau of Investigation (FBI) and OIG determined that the broker had obtained fraudulent loans on behalf of six people without their knowledge and consent. The broker used fictitious business information, which he listed on the applications, and in some instances, false tax returns, drivers' licenses, and social security cards. Although these false applications were not submitted under any of the SBA's loan programs, the investigation also found that the broker brought clients' applications for SBA-guaranteed loans to numerous SBA participant lenders. After his arrest and indictment, the broker pled guilty to **bank fraud**.

Chicago Businessman Enters Into Settlement Agreement. On November 10, 2004, a Chicago area businessman entered into a cash settlement agreement for his involvement in a conspiracy and fraud scheme committed against the SBA and a participating lender. The businessman settled the Government's claims against him in exchange for a \$100,000 cash payment to the SBA. The investigation involved a \$1.25 million SBA loan to purchase a restaurant. The parties of the transaction conspired to provide an unqualified borrower (an illegal alien and convicted felon) with the funds required for his capital injection. The businessman facilitated this scheme by providing a 5-day bank loan and another cash payment to the borrower, totaling more than \$400,000. The scheme essentially provided the borrower with 100 percent financing and resulted in a fraudulent inflation of the sales price, thereby exposing

the Government to additional loss and reduced recovery potential.

Maryland Seafood Business Owner Pleads Guilty. On November 9, 2004, the owner of a Maryland seafood business pled guilty to an Information charging him with **conspiracy to commit wire fraud**. A New Jersey seafood exporter received a \$400,000 SBA-guaranteed loan through a participating lender. The amount was to be disbursed in increments based on letters of credit and invoices from suppliers. On many occasions, checks from the seafood exporter bounced, resulting in approximately \$5,000 in debt owed to the Maryland seafood business. In order to satisfy the exporter's debt to the seafood business and help secure loan disbursements, a scheme was devised whereby the seafood business produced three false invoices totaling \$73,344, which were submitted to the lender. The owner of the seafood business admitted preparing the false invoices and keeping related excess funds. This case was referred by the SBA's New Jersey District Office.

Former Missouri Business Owner Pleads Guilty. On November 12, 2004, the former owner of a business in Missouri waived indictment and pled guilty to an Information charging her with **falsely representing the amount of equity cash injection** into her company for the purpose of obtaining an SBA-guaranteed loan. An SBA OIG investigation determined that the former business owner claimed to have injected at least \$241,100 into the business prior to the closing of a \$727,000 loan. The former business owner's false representations included a \$100,000 gift letter from her father, when this money was actually a loan. The former business owner made about five interest-only payments on the SBA-guaranteed loan before going out of business at the end of September 2000. This investigation was initiated based on a referral from the SBA District Office, St. Louis, Missouri.

Former Iowa Business Banking Associate Debarred. A former business banking associate in Davenport, Iowa, was debarred by the SBA, effective November 5, 2004. This debarment prohibits the banking associate for 3 years from participating in Federal financial and non-financial assistance programs, representing participants in such programs, and participating in Federal procurement transactions. The banking associate's debarment was based on his 2003 guilty plea to charges that he made a **false statement** to SBA in an effort to induce the SBA to pay its 80 percent guaranty on a defaulted business loan. The banking associate was sentenced to 3 years probation, with the first 6 months in-home confinement under electronic monitoring. This investigation was initiated based on a referral from the SBA Branch Office, Cedar Rapids, Iowa.

Texas Convenience Store Owners Indicted. On November 17, 2004, two proprietors of a convenience store and service station in Arlington, Texas, were indicted on one count each of **false claim of U.S. citizenship** and one count each of **making a false statement or claim to be a citizen of the United States with the intent to obtain a federal benefit or service.**

The proprietors were indicted for inducing a financial institution and the SBA to fund a \$480,000 SBA-guaranteed loan by falsely representing themselves as United States citizens on SBA Form 912. The investigation is being worked jointly with the Department of Homeland Security, Social Security Administration, Department of Agriculture, Texas Department of Public Safety, and the Texas Alcoholic Beverage Commission.

Texas Loan Broker Sentenced. A Houston, Texas, loan broker was sentenced on November 29, 2004, to 9 years in a Federal correctional facility with no parole. The broker was also ordered to pay more than \$14 million in restitution and forfeit \$2 million to the United States. The loan broker pled guilty to charges of **bank fraud** and **conspiracy to commit wire fraud and bank fraud** relating to his involvement in a fraudulent scheme involving at least \$28 million in SBA-guaranteed loans. The broker admitted that for a 2-year period, he brokered loans to individuals interested in purchasing convenience stores and caused these individuals to sign loan application documents that he knew were false. The broker then submitted these false documents to lenders. This investigation was initiated based on a referral from the Houston District Office.

Agency Completes Final Action on Audit of SBA's Oversight of the Fiscal Transfer Agent for the 7(a) Loan Program. In the audit, the OIG recommended that the Associate Deputy Administrator for Capital Access, in conjunction with the Assistant Administrator for Administration, determine whether any other remedies are needed concerning the inappropriate augmentation of SBA's appropriation. Based on the recommendation, the Office of the Chief Financial Officer and the Office of General Counsel (OGC) determined that the funds should be repaid from the SBA's Salaries & Expenses account into the Financing Account. OMB agreed and approved the apportionment.

Agency Completes Final Action on Report on SBA's Experience with Defaulted Franchise Loans. In the report, the OIG recommended that the Office of Financial Assistance (OFA) ensure that the Agency's printed and electronic information on franchises no longer state that franchise-based businesses are significantly more

successful than independent. As a result, OFA removed statements from their website that claimed franchise-based businesses are more successful than independent businesses. OFA also issued an information notice concerning the success rate of franchises vs. non-franchises.

Agency Completed Six Final Actions on Management Advisory Report on the Transfer of Operations to the National Guaranty Purchase Center. The following six final actions have been reported as being completed: 1) a representative of the National Guaranty Purchase Center will be present at Oversight Council meetings; 2) the Office of Capital Access (OCA) will track the status of all loans currently in the inventory; 3) the Center has developed new reports that meet management's goal of tracking liquidation and purchase production, including post-purchase productions as well as liquidation activities and pre-purchases; 4) OCA and OGC provided additional supervisors and attorneys who assisted in resolving the backlog of purchase reviews with demand dated prior to March 13, 2004, resulting in elimination of the backlog; 5) OCA has determined the appropriate number of support staff and loan servicing assistants needed to ensure that loan officers are not working outside their normal responsibilities; and 6) the National Guaranty Purchase Center has put written mail and file room procedures in place and all Center staff have received copies. All loans are now accounted for in the Herndon tracking system called MasterTrak.

## *Disaster Loan Programs*

Former Attorney Indicted on Charges of Wire Fraud. On November 23, 2004, a former attorney was indicted on charges of **wire fraud**. The former attorney claimed his firm had been located in downtown New York City on September 11, 2001, and received an SBA Disaster Loan. The investigation revealed that his firm was never located at that address. This investigation was based on a referral from the Grievance Committee of the 9th Judicial District of New York State.

## *Government Contracting and Business Development Programs*

OIG Issues Report on the Small Disadvantaged Business Program. On November 4, 2004, the OIG issued a report on its review of the Small Disadvantaged Business (SDB) Certification Program. The objective of the review was to determine whether SBA was properly evaluating the

qualifications of SDB-only applicant firms (i.e., those that are not also 8(a) firms) for certification as SDBs. Ten of the 970 companies approved for certification in FY 2003, were reviewed to determine whether criteria were met for the five eligibility elements of social disadvantage, economic disadvantage, ownership, control, and size. The review found that eligibility reviewers in SBA's Office of Certification and Eligibility did not adequately consider whether owners of companies applying for SDB certification were economically disadvantaged. Contrary to regulations, eligibility reviewers were also certifying companies as SDBs when their owners had defaulted on Government obligations. As a result, at least 3 of the 10 SDBs in our sample should not have been certified. Companies inappropriately obtaining SDB certification could receive Federal contracts which would otherwise be awarded to eligible SDBs. Additionally, there were data integrity problems with an SDB application tracking system and inadequacies in file safekeeping, as program officials could locate only two-thirds of the files requested for review by auditors. The report recommended that the Acting Associate Administrator for Business Development develop and implement procedures to improve the SDB review process and de-certify certain firms the auditors found to be unqualified for SDB certification. SBA Management generally agreed with three of the four findings, and with all but one of the recommendations. For the recommendation with which they disagreed, SBA management did not want to de-certify the firm found unqualified for program participation based on the owner of the firm's total assets without further investigation. SBA management agreed with the language of the remaining finding's title and the associated recommendations, but disagreed with the finding's premise that regulations prohibit applicants with prior Federal loan defaults from participating in the SDB Certification Program.

Former High Ranking State Official Indicted. On November 5, 2004, former high ranking official for the California Technology, Trade and Commerce Agency, which administered the SBA Small Business Development Center (SBDC) program for California, was indicted by a Federal grand jury. The former official was indicted on one count of **conspiracy**, one count of **false statements**, one count of **false claims**, and one count of **causing an act to be done**. In 1999, the official ran a homeless shelter for the U.S. Department of Housing and Urban Development (HUD) and the Los Angeles Homeless Services Authority. A joint OIG, HUD, and FBI investigation revealed that the official conspired with several co-conspirators and engaged in a

scheme to defraud HUD of more than \$600,000. This case developed from a referral by the SBDC Office.

Agency Completes Final Action on Audit of SBA's Process for Complying with the Federal Managers' Financial Integrity Act Reporting Requirements. The following final action has been reported as being completed: the Agency issued a SBA Procedural Notice to all Regional Administrators (RAs), District Directors (DDs) and other field managers that instructed them on the procedures for submitting the annual assertion of internal controls and informed them of their responsibilities in complying with the requirements of the FMFIA. All RAs, DDs and their "acting representatives" were trained about their responsibilities concerning FMFIA requirements.

Proactive Work. In an effort to proactively identify and correct problems at the onset, the OIG reviewed, cleared, and/or provided comments, as appropriate, on 14 documents, including proposed Standard Operating Procedures, Procedural/Policy/Information Notices, and Legislation.

This monthly update is produced by the SBA OIG,  
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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:

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