



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

October 2007 Update

### *Business Loan Programs*

Ongoing Investigation Results in Indictments/Guilty Pleas. In January 2007, agents from the SBA OIG and the U.S. Secret Service arrested 18 individuals sought in connection with a scheme in which a lender's former executive vice president and others, not employed by the lender, conspired to fraudulently qualify loan applicants for SBA-guaranteed loans. The scheme involved at least 76 fraudulent loans totaling about \$76 million. So far, the investigation has resulted in the indictment of 27 individuals, with most of these indictments pre-dating the January 2007 arrests cited above. Three of those indicted are currently international fugitives.

As a result of this investigation, the lender began to repay the SBA its guaranties for certain loans and cancel the guaranties on others. To date, SBA recoveries from the lender, together with potential cost savings from the withdrawal of the SBA guaranties, have totaled approximately \$16 million. This criminal investigation is continuing, with further indictments expected.

The following four cases are part of this ongoing investigation, which is being conducted jointly with the U.S. Secret Service.

- On October 1, 2007, the lender's former executive vice-president pled guilty to one count of conspiracy to defraud the SBA and one count of lying to a federal grand jury. The plea relates to his involvement in the scheme to fraudulently qualify loan applicants for SBA guaranteed loans, primarily for the purchase of gas stations. He is expected to be sentenced in January 2008, and faces up to 10 years in prison.
- On October 1, 2007, a former owner of a gas station and convenience store in Redford,

Michigan, was charged in a one-count superseding information with false statements; overvaluation of securities. On the same date, he entered a plea of guilty to the superseding information. The guilty plea relates to his knowingly overvaluing his net worth in a financial statement in order to obtain a \$1.4 million SBA-guaranteed loan. Charges against the seller of the business remain pending. The former owner defaulted on his loan and the SBA paid a claim of \$1,037,897.

- On October 15, 2007, a business purchaser pled guilty to two separate superseding informations, each charging one count of false statements; overvaluation of securities. On the same date, the seller pled guilty to a superseding information, also charging one count of false statements; overvaluation of securities. The pleas relate to the buyer falsely indicating that he gave the seller a down payment in the amount of \$365,000 as an equity injection for a \$1,310,000 SBA-guaranteed loan to purchase his business. The seller verified the false equity injection documents, which allowed the buyer to obtain the loan. This defaulted loan resulted in SBA paying a claim of \$876,590.
- On October 23, 2007, a former bank assistant vice president was sentenced to two years in prison, followed by five years supervised release, and was ordered to pay restitution of \$3,930,889 to SBA and SBA lenders. She previously pled guilty to one count of conspiracy to defraud the SBA and one count of misapplication of bank funds. The investigation determined that, working with a loan broker, she provided false verification of deposit letters that were used to verify the required borrower equity injections. She also provided unfunded cashier's checks, totaling more than \$2.8 million, which were used in connection with loan closings.

Business Owner Indicted. On October 4, 2007, a former business owner was indicted in the Northern District of Illinois on one count of committing bank fraud and one count of bank entries, reports and transactions. The indictment alleges that he provided a false bank account verification letter in order to persuade the lender and the SBA to approve a \$1.35 million SBA-guaranteed loan and, in addition, provided fraudulent cashier's checks at the loan closing. The indictment also alleges that the former business owner submitted false documentation to another lender in order to influence the approval of a \$1.2 million home equity line of credit. This investigation has already revealed that, in addition to obtaining an SBA loan for himself, the former business owner, operating as a company, brokered approximately 40 SBA-guaranteed loans through the lender. An extensive review of the documentation for these loans revealed that fraudulent equity injection documentation was provided in at least 25 separate instances. The OIG is conducting this joint investigation with the Federal Bureau of Investigation (FBI).

## *Disaster Loan Program*

OIG Issues Report on The Quality of Loans Processed Under the Expedited Disaster Loan Program. On September 28, 2007, the OIG issued an audit report, *The Quality of Loans Processed Under the Expedited Disaster Loan Program*. The audit disclosed that 32 percent of loans made under expedited procedures, or an estimated \$1.5 billion in loans, were awarded to applicants who lacked repayment ability. The audit results were similar to findings made by SBA during a Quality Assurance Review, which showed that 28 percent of applicants processed under the Expedited Program potentially could not repay their loans. Loan decisions under the Expedited Program were based primarily on credit scores, regardless of an applicant's income level and expenses.

The OIG recommended that SBA review canceled loans that were approved under expedited procedures to identify applicants who lacked repayment ability, notify those applicants of their potential eligibility for Federal Emergency Management Agency (FEMA) assistance, and make the appropriate FEMA referrals. The OIG also recommended that the Agency review the creditworthiness of borrowers associated with undisbursed home loans and refer those borrowers to

FEMA, as appropriate. SBA agreed to contact as many of these borrowers as possible.

Mississippi Resident Indicted. On October 10, 2007, a Mississippi resident was indicted on two counts of false claims, two counts of false statements, two counts of theft of government funds, and one count of forfeiture. The indictment alleges that he caused physical damage to his own residence in order to fraudulently receive a \$40,000 disaster loan from SBA, as well as approximately \$4,000 from FEMA. The OIG is conducting this investigation jointly with the FBI and the U.S. Postal Inspection Service.

Two Individuals Indicted. On October 22, 2007, two individuals were indicted in U.S. District Court for the Southern District of Mississippi. The indictments allege disaster benefit fraud as noted below.

- The first individual was indicted on one count of false claims, three counts of false statements, two counts theft of government funds, four counts of wire fraud, and one count of forfeiture. The indictment alleges that she claimed a secondary home as her primary residence on Hurricane Katrina federal disaster benefit applications, and that her husband claimed their actual primary residence separately. This investigation is being worked jointly with the Department of Homeland Security OIG, the Mississippi State Auditor's Office (MSAO), and U.S. Department of Housing and Urban Development OIG (HUD/OIG).
- The second individual was indicted on one count of false claims, five counts of false statements, one count of theft of government funds, one count of food stamp fraud, two counts of mail fraud, and one count of forfeiture. The indictment alleges that he provided false statements on Hurricane Katrina federal disaster benefit applications regarding his residency at the time of the hurricane. The SBA OIG is conducting this joint investigation with the FBI, the MSAO, and U.S. Department of Agriculture OIG.

## ***Government Contracting and Business Development***

### Co-conspirators at Fort Sam Houston Plead Guilty.

On September 28, 2007, a civilian contracting officer and a coordinator/project officer from Fort Sam Houston pled guilty to one count of conspiracy and one count of acceptance of a bribe by a public official, and the owner of an SBA-certified 8(a) consulting firm pled guilty to one count of conspiracy and one count of bribery of a public official. On October 11, 2007, a San Antonio contractor consultant pled guilty to one count of conspiracy to defraud the United States, one count of bribery of a public official, and one count of engaging in a monetary transaction in criminally derived property. On the same date, a contract government employee pled guilty to one count of conspiracy to defraud the United States, one count of acceptance of a bribe by a public official, and one count of failure to file an income tax return. All five individuals were previously indicted in connection with a multimillion-dollar fraud scheme centered on steering Department of Defense contracts to a company owned by one of the defendants.

In addition to criminal charges, the indictment also seeks a monetary judgment of \$1.2 million. The SBA OIG is conducting this investigation jointly with the FBI, Internal Revenue Service, U.S. Army Criminal Investigation Command, General Services Administration OIG, Department of Interior OIG, and Defense Criminal Investigative Service.

### OIG Issues Report on Review of SBA's Subcontracting Assistance Program.

On September 28, 2007, the OIG issued a report on a review of SBA's Subcontracting Assistance Program. The OIG reported that SBA performed only limited oversight of large prime contractors' subcontracting plans, which resulted in billions of dollars of subcontracts escaping oversight. In fiscal year 2006, only 968 (less than half) of an estimated 2,200 large prime contractors were reviewed, and most of the reviews were off-site or relied heavily on contractors' self-reported achievements. In addition, SBA had sharply curtailed active marketing and matchmaking activities of its Commercial Market Representatives (CMRs), and revised its regulations to eliminate the matchmaking function. Further, while SBA incorporated into the Agency's scorecard a performance goal for the number of compliance reviews it should conduct annually, this

performance goal was not a measure of how effective the program has been at increasing the percentage of subcontract awards to small businesses.

The OIG recommended that the Agency develop an annual performance plan for the Subcontracting Assistance Program that establishes performance goals that more directly measure program effectiveness, and annually report the number and dollar value of subcontracts to small businesses, as required by law.

## ***Agency Management***

### OIG Issues Report on Controls Over Access to Employer Emails by SBA Managers.

On October 19, 2007, the OIG issued a report, *Controls Over Access to Employee Emails by SBA Managers*. The review examined whether management in the Office of Disaster Assistance (ODA) had improperly retrieved emails originating from an employee who was a confidential source to the OIG and a Congressional committee. The OIG determined that ODA managers accessed an employee's emails without seeking approval from or notifying the Chief Information Officer (CIO). The CIO advised that she and her staff were unaware of the circumstances or actions relating to ODA's review of the emails and that, as the Agency's Chief Privacy Office, ODA should have obtained her authorization.

The CIO also advised that her office had not issued any written guidance on how email reviews should be authorized. In the absence of a centralized authorization process and written guidance for conducting administrative review of employee emails, SBA had no assurance that appropriate safeguards were consistently employed. Moreover, SBA lacked the ability to monitor who was reviewing employee emails, or the frequency or purposes of such reviews, and although review of employee emails may have been justified, the absence of controls created an environment where employee emails could be subject to unauthorized access or reviewed for illegitimate purposes.

The report recommended that the CIO communicate to individuals with system administrator rights that requests for email retrievals must be approved centrally by her office, and that Standard Operating Procedure 90 49, *Appropriate Use of SBA's Automated Information Systems*, be revised to

establish appropriate protocols for conducting administrative inquiries and reviews of employee emails. The CIO agreed with the OIG's recommendations. ODA also agreed with the recommendations, but asserted it had not committed any violations as no policies and procedures were in place.

OIG Issues Report on Audit of the E-Applications System. On September 27, 2007, OIG issued a report on an audit of the E-Applications System, an internet system that processes applications for the 8(a) and Small Disadvantaged Business certification programs. The audit disclosed that there were inadequate safeguards over sensitive government data and insufficient controls to ensure the complete and accurate transfer of information from the E-Applications system to SBA's Electronic 8(a) Review System. The OIG recommended that the Agency modify the vendor contract to require the development of security procedures, data backup procedures, and contingency capabilities; establish appropriate data transfer controls; and validate the accuracy of data already transferred from E-Applications to SBA systems. The Agency generally concurred with the audit findings and recommendations.

### ***Statutory/Regulatory/Policy Reviews***

In an effort to proactively identify and correct potential Agency inefficiency and management problems at the onset of policy and regulatory development, the OIG reviewed, cleared, and/or provided comments, as appropriate, on 20 Agency initiatives, including proposed legislation, SBA Standard Operating Procedures, and Agency notices containing directives to its employees.

This monthly update is produced by the SBA OIG, Eric M. Thorson, Inspector General.

The OIG has established an e-mail address ([oit@sba.gov](mailto: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 these documents please contact:

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