



Office of Inspector General U.S. Small Business Administration

September 2003 Update

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Business Loan Programs

Texas Real Estate Proprietor Arrested for Bank Fraud.

A Dallas, Texas, real estate proprietor was arrested August 28, 2003, for **bank fraud** involving his packaging/brokering of 10 Small Business Administration (SBA)-guaranteed loans. Specific charges are pending. A co-conspirator in this scheme pled guilty to **an Information** on August 23, 2001. He was sentenced on January 14, 2002, to 5 years probation and ordered to pay restitution of \$50,000. His guilty plea and sentencing were sealed until his partner's arrest. Specifically, he pled guilty to one count of **false statements** to SBA for submitting a false gift letter for \$250,000. This investigation was initiated based on a referral from the participating lender. SBA OIG is conducting this investigation jointly with the Federal Bureau of Investigation (FBI).

Oregon Restaurant Owner Sentenced. A former restaurant owner in Portland, Oregon, was sentenced on August 11, 2003, to 37 months in prison, followed by 5 years supervised release. He was also ordered to pay \$306,451 in restitution to SBA, and the financial

institution. He was permitted to voluntarily surrender to the U.S. Marshals on September 25, 2003. He was previously indicted on May 23, 2002, by a Federal Grand Jury in the District of Oregon for making material **false statements** on multiple loan applications to two financial institutions. Additional charges included his use of false social security numbers to obtain the questioned loans. He also failed to disclose prior bankruptcies, judgments, other business interests, and a previous criminal history. He was previously arrested and arraigned on May 28, 2002, in connection with these charges. SBA OIG conducted this investigation jointly with the FBI.

Texas Man Pleads Guilty to Making a False Statement.

The president of an investment company, doing business as a convenience store and service station in Palestine, Texas, pled guilty by way of Information on August 15, 2003, to making a **false statement** to the SBA. He falsely and willfully represented himself to be a citizen of the U.S. to both SBA and a financial institution, inducing them to fund a \$1,190,000 SBA-guaranteed loan. The OIG conducted this continuing investigation jointly with the Department of the Treasury's OIG for Tax Administration, Department of Homeland Security, Social Security Administration, Texas Department of Public Safety, and the Texas Alcoholic Beverage Commission.

Washington Man Pleads Guilty for Making a False Statement and Bank Fraud.

A former business owner in Cheney, Washington, pled guilty on September 11, 2003, for making a **false statement** to SBA and one count of **bank fraud**. The false statement charge pertained to statements that he made to obtain an \$880,000 SBA-guaranteed loan from a financial institution. He concealed notes payable totaling \$305,000, a \$60,000 gambling debt, and the sale of 10 percent of his investment group for \$100,000 a few days before signing the loan documents. The **bank fraud**

count pertained to the submission of a false car loan application to a bank. In exchange for his plea and his acceptance of the full loss, the Government dropped the remaining 24 counts of **bank fraud** for which he was charged on May 6, 2003. The investigation into **bank fraud** found that from March 1999 through August 2001, he submitted 16 fraudulent retail contracts to a bank, to cover for taking \$608,714.65 from a dealer account at the bank. Upon the discovery of his fraudulent actions, he entered into a repayment agreement with the bank. Meanwhile, he submitted nine fraudulent loan applications to another bank in August 2001, resulting in a loss of \$381,444.94. He used the names, addresses, social security numbers, and other personal information of current and former clients on loan applications without their knowledge or approval, and submitted the applications to the bank, fraudulently receiving \$391,528.60. He repaid a portion of his debt to the bank with the money he had absconded from another bank.

Virginia Man Pleads Guilty to an Information. The initial director of two management corporations pled guilty, on September 10, 2003, to **an Information** that was previously filed on August 19, 2003. He was charged with one count of **conspiracy to commit wire fraud**. The management corporations were borrowers that obtained two SBA-guaranteed loans totaling \$3,270,000 for the purpose of purchasing two adjacent motels in Norfolk, Virginia. The conspiracy count related to the director conspiring to inflate the purchase price of the properties by \$148,000 to fraudulently obtain loan proceeds from a business loan center and a bank. He conspired to inflate the purchase price by a scheme to have the corporations pay \$550,000 from the loan proceeds to a development corporation, a company owned by the director, for repairs that never took place. He also conspired to pay \$200,000 to each of the stockholders of the corporations and disbursed \$198,000 of the loan proceeds to purchase another motel. He also conspired to submit false statements to the loan center and bank regarding the assets and liabilities of the shareholders of the corporations. He accomplished this by falsely stating that he was giving a combined gift of \$825,000 to the two shareholders of the corporations 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 the loan center to wire loan funds in the amount of \$2,270,000 and the bank to wire loan funds in the

amount of \$996,230 to the management corporations. This is an ongoing joint investigation with the FBI. He was required to surrender his Canadian passport and is scheduled for sentencing on January 14, 2004.

Wyoming Sporting Goods Owner Pleads Guilty to Making a False Statement. An owner of a sporting goods store in Laramie, Wyoming, pled guilty, on September 11, 2003, to making a **false statement** to SBA. He was previously indicted on two felony counts but in return for his guilty plea, the Government agreed to dismiss the other count. The joint investigation with the FBI determined that he submitted to the bank two false personal financial statements in order to obtain two separate SBA loans totaling \$250,000. He failed to disclose four additional debts totaling approximately \$312,000 on his financial statements. The investigation also disclosed that he faxed several loan documents in furtherance of his scheme to defraud the SBA and the bank. This case was initiated based on a referral from the SBA Wyoming District Office and the FBI.

SBA Denies Liability Under its Guaranty Agreement. The Associate Deputy Administrator for Capital Access concurred with the SBA New Jersey District Office on September 4, 2003, and **denied liability** under its guaranty agreement with a bank the amount of \$110,022.27, for a loan made to a Delran, New Jersey business. The applicants obtained a \$149,000, SBA-guaranteed loan through the bank to purchase an existing business. Subsequently, the borrowers defaulted on their loan and the lender requested that SBA honor its 75 percent guaranty. The SBA/OIG investigation determined that the bank did not properly liquidate this loan. Specifically, the bank advised SBA in a Liquidation Plan, dated June 27, 2002, that the landlord had disposed of the equipment citing that it was in poor condition. The investigation disclosed the landlord had made numerous attempts to have the bank remove the loan collateral from the business site but to no avail. Subsequently, the landlord rented the space and leased the abandoned equipment to his new tenant. Further, the bank failed to make site visits in a timely manner as required by SBA regulations. The U.S. Attorney's Office in Camden, New Jersey declined this matter for criminal prosecution, in lieu of administrative action.

Pennsylvania Attorney Sentenced. A Pottstown, Pennsylvania, attorney was sentenced on September 4, 2003, to 21 months in prison and 3 years supervised probation after his time is served. He was

also ordered to pay \$172,000 in restitution; \$107,000 of this amount will be paid to the SBA and an investment corporation, to pay off the loan. The balance of the restitution will be paid to creditors in his bankruptcy proceeding. He was also ordered to pay a \$5,000 fine and a \$300.00 special assessment. The judge further ordered him to immediately pay restitution from \$40,000 he had in a retirement fund and \$16,000 he had in securities. As a result of this investigation, he was fired by the school district in Pennsylvania, where he was a teacher, and is prevented from holding a teaching position after he completes his prison term. He also has been disbarred from practicing law. He previously pled guilty in December 2002, to one count of **wire fraud**, one count of **bankruptcy fraud**, and one count of **perjury**. These charges were detailed in a criminal information that was filed against him on October 15, 2002, and related to a scheme to steal \$107,000 in SBA-guaranteed loan proceeds obtained from an investment corporation in September 1997. He was teaching business ethics at a Pennsylvania community college at the time he committed this fraud. This case was initiated based on a request from the FBI. SBA OIG conducted this investigation jointly with the FBI.

OIG Issues Three Audit Reports on Section 7(a) Guaranteed Loans. The first audit report was issued on September 24, 2003, and concerns a loan made to a spice company under the Section 7(a) Loan Program. The lender did not use prudent lending procedures to process this Section 7(a) loan to the borrower. PLP lenders are required to conduct a credit analysis, complete a repayment ability and eligibility review, and evaluate the sufficiency and source of capital injection. The lender, however, did not adequately determine the borrower's repayment and management ability, nor did it evaluate the eligibility of the debt being refinanced or the source of capital injection. As a result, SBA made a \$316,165 improper payment when the guaranty was purchased from the secondary market.

On September 24, 2003, OIG issued the second audit report concerning an SBA-guaranteed loan that was transferred to liquidation within 18 months of approval. The lender disbursed loan proceeds before completing a required environmental study. The borrower defaulted on the loan 18 months after disbursement during which time the value of collateral

diminished significantly, primarily due to property contamination. Consequently, SBA was not obligated to honor the guaranty due to the lender's imprudent actions. When these issues were brought to the lender's attention, the lender withdrew a request for payment and released SBA from the \$768,948 guaranty.

On September 29, 2003, OIG issued the third audit report on an SBA guaranteed loan to a concrete company. The report found that the lender did not take adequate actions to protect and secure collateral from loss. The lender waited 6 months to inventory and assess the condition of collateral after learning that the prior owner (seller) had removed collateral from the small business. At liquidation, several pieces of collateral were missing. As a result, the loss to SBA was increased by \$273,675, when SBA improperly paid the guaranty in full. The audit recommended that SBA recover \$227,675 from the lender. SBA management agreed to seek recovery on the guaranty based on the results of the audit.

OIG Issues Inspection Report on Citizenship Status. On September 30, 2003, the OIG issued an inspection report on **Insufficient Proof of Citizenship Status for SBA Loans**. Recent OIG investigations have identified borrowers who misrepresented their citizenship status in order to obtain SBA guaranteed loans, despite the fact that non-citizens (i.e., aliens) can receive SBA loans if they meet certain requirements. Because of such misrepresentations and the effects of antiterrorism legislation, this inspection's focus was to identify the requirements for determining citizenship eligibility as well as potential vulnerabilities.

The OIG found that SBA and its lenders have little assurance that prospective borrowers truthfully disclose their citizenship status. The Agency cannot be reasonably certain that its loan programs benefit only eligible citizens or legal aliens because of reliance on prospective borrowers' honesty, concerns about loan origination delays, concern over the appearance of discriminatory practices, and the lack of a definitive national identification system for foreign nationals. The report recommended that, consistent with the USA PATRIOT Act, SBA issue an interim directive instructing its lenders to verify the identities of new customers involved with Agency programs. Accordingly, SBA drafted a notice for review through the Agency's clearance process.

In addition, the OIG found that SBA cannot readily determine how many loans go to citizens and how many to aliens. Although the Agency's lending partners collect citizenship status information, SBA's loan databases do not contain such data. If the databases had the data, the Agency could identify potential trouble spots in its portfolio and perform programmatic research. The report recommended that SBA collect citizenship status data, including available alien registration numbers, in its loan databases. The Agency has not yet made a management decision on this recommendation.

Disaster Loan Program

OIG Issues Audit Report on the Disaster Credit Management System. On September 24, 2003, a final audit report was issued on SBA's Implementation of the Disaster Credit Management System (DCMS). The objectives of the audit were to monitor SBA's implementation of DCMS to ensure that SBA (1) has adequate safeguards, controls and testing before DCMS is placed into a production status, and (2) complies with overall objectives of the SBA Systems Development Manual (SDM). The audit disclosed the following: (1) SBA had not conducted a security risk analysis for the DCMS project. This occurred because the Office of the Chief Information Officer (OCIO) was not fully engaged in project oversight to identify this potential vulnerability; (2) Security requirements for DCMS had not been fully determined before important decisions were made as to selecting Computer Off-The-Shelf (COTS) software; (3) SBA had not prepared a security plan for DCMS on time; (4) SBA had not planned to conduct an independent verification and validation of DCMS before it went into production; (5) SBA had not planned to conduct a certification and accreditation review of DCMS before it went into production, and (6) OCIO did not provide adequate oversight of the DCMS development project.

The auditors made six recommendations to correct the deficiencies identified in the report. In a joint response, the Associate Administrator for Disaster Assistance and the Chief Information Officer generally agreed with five recommendations and disagreed with one recommendation. The OIG attempted to resolve the disagreement in a meeting with ODA officials but

were unable to do so. Consequently, we kept the disputed recommendation in the final report.

Government Contracting and Business Development Programs

Agency Completes Eight Final Actions on Audit of the National Women's Business Council. In an audit of the National Women's Council (NWBC), the OIG recommended that the Executive Director ensure that NWBC members and staff receive written guidance and training on appropriations law dealing with the distinctions between contracts, grants, and cooperative agreements, as well as notification that NWBC does not have grant and co-sponsorship authority. All NWBC staff received SBA training. The OIG also recommended that the Executive Director review relevant laws with NWBC members and staff to ensure that they understand the lobbying restrictions imposed on Government employees and the requirements of NWBC's makeup and how members are to be appointed. Another recommendation required that the Executive Director take the necessary steps to ensure that all NWBC staff is knowledgeable about the relevant travel regulations. As a result, all NWBC staff met with a member of the Office of the Chief Financial Officer (OCFO) to go over travel regulations. Another recommendation called for ensuring that travel vouchers are completed and supporting documentation maintained to support all future invitational travel. The Executive Director will review all invitational travel authorizations and ensure that vouchers are prepared. To satisfy another recommendation, a notice was issued requiring the Executive Director to obtain prior written authorization for her travels. Another recommendation was satisfied when the OCFO issued a notice to provide guidance on the Business Assistance Trust Fund (BATF). The notice outlines several new procedures, which will help SBA to provide adequate oversight over the BATF. The OIG also recommended that the Executive Director implement controls to ensure that statutorily required reports are prepared and submitted to appropriate officials in a timely manner.

Agency Management

OIG Issues Audit Report on Information Security. On September 17, 2003, a final audit report was issued on the OIG's Independent Evaluation of SBA's Information

Security Program. The Federal Information Security Management Act (FISMA) requires the Office of Inspector General (OIG) to perform an independent evaluation of the Small Business Administration's (SBA) information security program. This report presents the results of that evaluation in accordance with specific FISMA reporting instructions issued by the Office of Management and Budget (OMB). Generally, SBA's information security program continues to improve for high priority financial management and general support systems. However, material weaknesses and security vulnerabilities continue to exist in: (1) computer intrusion detection and incident escalation procedures, (2) security controls in the systems development life-cycle, (3) system access controls, (4) system certification and accreditation, and (5) disaster recovery and contingency planning.

This report did not contain any recommendations. The report will be included as part of the Agency's FISMA submission in accordance with OMB guidance.

OIG Issues Final Report on Travel and Purchase Cards. On September 29, 2003, a final audit report was issued on Travel Card and Purchase Card Controls. The objectives of the audit were to determine if adequate controls exist to prevent and detect inappropriate use of travel and purchase cards, and whether the travel cards are held only by SBA employees. The audit disclosed the following:

The Denver Finance Center (DFC) identified only 213 of 1,968 inappropriate travel card transactions that we identified in our audit. When potential misuse was identified, DFC did not always follow through to determine if actual misuse had occurred. Accordingly, supervisors were not always notified of the inappropriate transaction.

SBA's internal controls did not ensure that individual accounts were always cancelled or de-activated when an employee left the Agency. There were 264 active travel card accounts maintained by separated employees on July 16, 2002.

Purchase card statements in various SBA offices showed no evidence that approving officials reviewed the statements to ensure that the charges were for authorized purchases.

Four recommendations were made to the Chief Financial Officer (CFO) and one recommendation was made to the Assistant Administrator for Administration to correct the deficiencies identified in the report. The CFO generally disagreed with the audit recommendations addressed to him. We addressed CFO's comments and made minor changes to the final report, as deemed necessary. The Assistant Administrator for Administration agreed with the recommendation and has already taken final action to resolve the matter.

Agency Completes Final Action on Two Recommendations Resulting from an Audit of SBA's FY 2002 Financial Statements. In an audit report on SBA's FY 2002 Financial Statements, the OIG recommended that the Administrator assess whether SBA has devoted sufficient resources to adequately address its current financial reporting shortcomings and determine if the current process will need re-engineering and additional resources to enable SBA to meet accelerated financial reporting deadlines. The OCFO began an internal review of its current financial reporting process and plans to consider what changes are necessary to meet the accelerated financial reporting deadlines in future years starting with FY 2003. In addition, the Administrator approved the funding for financial management improvements. The second final action taken was to re-engineer and enhance its quality control process and continue to develop its documented financial reporting process in order to avoid submitting draft financial statements and related footnotes containing material and widespread errors and misclassifications.

Final Action Completed on Audit of SBA's Fiscal Transfer Agent. In an audit of SBA's Fiscal Transfer Agent for the 7a Loan Program, OIG recommended that the CFO work with the Office of Management and Budget (OMB) and Treasury to properly establish symbols and titles for the SBA Master Reserve Fund (MRF). The CFO has agreed to work with OMB and Treasury to establish accounts to include the MRF under Federal Credit Reform.

Agency Completes Final Action on Two Recommendations Resulting from an Audit of SBA's FY 2002 Financial Statements – Management Letter. In an audit of SBA's FY 2002 Financial Statements – Management Letter, OIG recommended that the CFO coordinate with the offices of Capital Access and Field Operations to dedicate the time and personnel to

properly value SBA's Colpur account in accordance with existing policy and procedures, and Federal accounting procedures. The Office of Capital Access and the Office of Field Operations transmitted a request to all District Directors having collateral balances to review the status and valuation of the collateral by September 30, 2003. The second final action was complete when the OCFO agreed to work with Office of Procurement and Grants Management (OPGM) to encourage timely deobligations prior to and at year end. The OCFO will produce its annual end-of-year notice detailing the deadlines for obligations and will make suggestions to OPGM on the timely closeout of contracts and other deobligation actions necessary. OCFO also agreed to provide periodic reports of open obligations.

The activity Update is produced by SBA/OIG,
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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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