



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

September 2004 Update

### *Agency Management*

Agency Completes Final Action on Audit of SBA's FY 2003 Financial Statements. The following final action resulting from the audit has been reported as being completed: the Office of the Chief Financial Officer (OCFO) completed the checklist for reports prepared under the CFO act, as issued jointly by the Government Accountability Office, formally the General Accounting Office, and the President's Council on Integrity and Efficiency. This checklist addresses the adequacy of financial statement presentation and disclosure.

Agency Completes Two Final Actions on Audit of SBA's FY 2003 Financial Statements – Management Letter. The following two final actions have been reported as completed: 1) the OCFO researched FY 2004 undelivered orders using a sampling approach and found that all of the sampled items were proper and supported by document processing in ORACLE, 2) OCFO completed the Surety Bond Guaranty (SBG) loss study review and budgetary authority estimate for FY 2006 in preparation for the FY 2006 budget.

OIG Issues Audit Reports on SBA's Support Systems. On September 10, 2004, the OIG issued two reports prepared by its contract auditors on SBA's Support Systems. Both reviews utilized National Institute of Standards and Technology and National Security Agency (NSA) guidelines for configuring general support systems. In the reports, the auditors determined that SBA's Exchange Email System, UNIX servers, firewalls and routers did not follow a standard system configuration. Additionally, the auditors determined that SBA's email system was vulnerable to possible security exploits that could compromise the system. The findings were issued to the Chief Information Officer (CIO) under limited distribution. The CIO/Office of Chief Operating Officer was in general agreement with the findings. Actions to address the findings and recommendations will be evaluated during the audit resolution process.

OIG Issues Summary Audit Report of SBA Sponsored and Cosponsored Events. On September 24, 2004, the OIG issued a summary audit report of SBA Sponsored and Cosponsored Events Conducted by District Offices. The audit disclosed that, for 16 SBA sponsored and 33 cosponsored events held between May 1999 and November 2002, nine district offices did not operate in compliance with Federal laws and SBA policies and procedures. The audit disclosed the following areas of noncompliance: 1) soliciting and accepting gifts and fees; 2) planning, conducting, and reporting events; and 3) maintaining accountability for funds and non-cash assets. The following causes were noted: 1) failure of field office personnel to follow existing guidance; 2) inadequate and nonexistent guidance; and 3) insufficient oversight by Headquarters and regional personnel. As a result, SBA personnel operated in violation of Federal laws and SBA requirements. The OIG recommended that the Associate Administrator for Office of Strategic Alliances: 1) develop a training program for district office employees who will be involved in SBA sponsored and cosponsored events; 2) develop standard operating procedures (SOP), in coordination with OGC, addressing all aspects of SBA sponsored events; and 3) revise SOP 90 75 2. The OIG also recommend that the Associate Administrator for Office of Field Operations: 1) ensure that district office personnel receive appropriate training before planning, conducting, and managing funds related to SBA sponsored and cosponsored events, and 2) require that regional office personnel periodically review district office files of events for completeness and compliance. SBA officials agreed with five of the recommendations and partially agreed with two. Regarding the recommendations with which it partially agreed, SBA indicated that it would clarify existing procedures.

### *Business Loan Programs*

OIG Issues Two Audit Reports on Early Defaulted Loans. On September 12, 2004, a final audit report on an early

defaulted loan disclosed that the lender made material errors in calculating the borrowers' cash flow and repayment ability. According to SBA procedures, repayment from the cash flow of the business is the most important consideration in the loan making process. Because material expenses were excluded from the cash flow analysis, the lender made an SBA-guaranteed loan that should have been declined due to a lack of repayment ability. Consequently, SBA made a \$246,460 erroneous payment when it honored the guaranty. OIG made a recommendation for full recovery. A second report, issued on September 17, 2004, revealed that the lender did not use prudent lending procedures to process the Section 7(a) loan. The audit disclosed that the lender did not: 1) verify the borrower's equity injection; 2) require a standby agreement for the injection; 3) question the borrower's lack of managerial experience; 4) properly account for use of loan proceeds; 5) require a guarantor; and 6) obtain an appraisal that met the required estimate. Consequently, SBA made a \$293,823 erroneous payment when it repaired the guaranty. OIG made a recommendation to recover the full amount of the guaranty paid to the lender.

Texas Convenience Store and Service Station Proprietor Indicted. The proprietor of a Fort Worth, Texas, convenience store and service station was indicted on September 8, 2004, on one count of **false claim of U.S. citizenship**, a violation of Title 18 USC 911, and one count of **making a false statement or claim to be a citizen of the U.S. with the intent to obtain a federal benefit or service**, a violation of Title 18 USC 1015(e). The proprietor was indicted for inducing SBA and the bank into funding an \$875,000 SBA-guaranteed loan by falsely representing himself as a U.S. citizen on SBA Form 912. The SBA OIG is conducting this continuing investigation jointly with the Department of Homeland Security (DHS), Social Security Administration (SSA), Department of Agriculture, Texas Department of Public Safety, and Texas Alcoholic Beverage Commission (TABC).

Sixteen California Individuals Indicted. On September 9, 2004, in the Northern District of California, 16 individuals and two corporations were charged in a 38 count indictment with **conspiracy to make false statements to influence banks, conspiracy to commit wire fraud, false statements to influence banks, wire fraud, and money laundering**. Four of the 16 individuals were charged in a second five count indictment with **harboring illegal aliens, engaging in a pattern and practice of hiring illegal aliens, and engaging in a pattern and practice of continuing to**

**employ illegal aliens.** Two of the individuals owned or controlled 60 convenience stores located throughout Northern California. The owners used straw borrowers and nominee borrowers to apply for and obtain loans guaranteed by SBA, various banks, and non-bank lenders. The use of straw borrowers allowed the owners and their associates to conceal the owners' financial interests in the individual businesses, conceal the true source of the cash injection for each SBA loan, and launder the proceeds of each SBA loan through the use of wires and checks. Actual and intended losses caused by this scheme range between \$120,000 and \$20,000,000. In addition, these individuals hired and harbored illegal aliens at businesses owned and controlled by them. OIG continues to conduct this joint investigation with the Federal Bureau of Investigation (FBI), Internal Revenue Service (IRS), Immigration and Customs Enforcement, Department of Agriculture, and the State of California's Alcohol and Beverage Control.

Texas Convenience Store and Service Station President Sentenced. On September 28, 2004, the president of a convenience store and service station in Fort Worth, Texas, pled guilty and was sentenced to 2 years probation. The guilty plea was for **making a false statement or false representation** on a sworn renewal application for a Texas Alcoholic Beverage Commission permit. The president also submitted a false SBA Form 912 stating he was a U.S. citizen in his application for a SBA-guaranteed loan. He falsified documents inducing a bank and SBA to fund a \$1,115,000 SBA guaranteed loan.

Three Puerto Rico Businessmen Indicted. On September 22, 2004, three Puerto Rico businessmen were indicated in relation to two microloans totaling \$50,000. A co-owner of the business was indicted on one count of **conspiracy**. Another co-owner was indicted on one count of **conspiracy**, one count of **making false statements to SBA**, and one count of **making a material false statement**. The office manager was indicted on one count of **conspiracy**, one count of **making false statements to SBA**, and one count of **making a material false statement**. A co-owner had been denied an SBA microloan because of poor credit history and conspired with the other co-owner (also his brother) and the office manager, who applied for SBA microloans on his behalf. Each received a \$25,000 loan. On their applications, they claimed the loans were to purchase inventory for their respective businesses when the monies were actually for the use and benefit of the other co-owner. This investigation was based on a referral from the lender. OIG is conducting this ongoing investigation jointly with the FBI.

Agency Completes Final Action on Audit of Borrowers with Prior Defaulted Loans. As a result of the audit, the following final action has been reported as completed: the Office of Field Operations issued an SBA Information Notice to all SBA employees concerning the retention of charge-off loan files.

Agency Completes Two Final Actions on Audit of SBA's Fiscal Transfer Agent for the 7(a) Loan Program. The following two final actions have been reported as completed: 1) the OCFO has appointed a Technical Point of Contact for the Colson Fiscal Transfer Agent Contract; and 2) the Office of Financial Assistance has provided a Statement on Auditing Standards (SAS) 70 Audit Report for Colson Services Corporation.

## ***Disaster Loan Program***

New York Doctor Sentenced. On September 28, 2004, a New York doctor was sentenced to 2 years probation and 1 month home confinement, and ordered to pay a \$5,000 fine. The doctor pled guilty on June 2, 2004, to two misdemeanor counts of **fraudulently demanding or endeavoring to obtain money from the U.S.** As previously reported, the doctor was originally indicted on September 5, 2002, on three felony counts of **false statements** and one count of **conspiracy** in connection with SBA and FEMA applications, executed in her name and on behalf of her mother, for disaster relief funding pursuant to Hurricane Floyd, which allegedly damaged her mother's home. A superseding indictment on April 29, 2004, later charged the doctor with three felony counts of **making false statements** for claiming equipment damages in connection with a disaster loan that was approved for \$88,400. The investigation revealed that there was never any medical equipment stored at the residence of her mother. The doctor also submitted a false lease agreement in furtherance of her fraud scheme. This case was initiated based on a referral from a private individual. SBA OIG conducted this investigation jointly with the FBI.

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

Agency Completes Final Actions on Two Recommendations in Audit of Minority Business Enterprise Legal & Defense Education Fund, Inc. (MBELDEF) Cosponsorship Expenses and Income. MBELDEF and SBA executed a Settlement Agreement and General Release agreeing that: 1) SBA made

overpayments to MBELDEF; and 2) MBELDEF owes reimbursement for the overpayments. MBELDEF agreed to pay SBA an agreed upon amount over a 10 year period.

This monthly update is produced by the SBA OIG, Harold Damelin, Inspector General.

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:

Teresa Clouser, SBA/OIG  
409 Third Street SW., 7<sup>th</sup> Floor  
Washington, DC 20416  
e-mail: [OIG@SBA.GOV](mailto:OIG@SBA.GOV)  
Telephone number (202) 205-6580  
FAX number (202) 205-7382

Many audit and inspection reports can be found on the Internet at <http://www.sba.gov/IG/igreadingroom.html>

If you are aware of suspected waste, fraud, or abuse in any SBA program, please call the:

**OIG FRAUD LINE at (202) 205-7151**  
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