



Office of Inspector General U.S. Small Business Administration

December 2009 Update

Business Loan Programs

Review of 7(a) Recovery Act Loans. The OIG is conducting an audit of 7(a) loans disbursed pursuant to the Recovery Act to determine whether the loans were originated and closed in compliance with SBA policies and procedures and to identify any evidence of suspicious activity. In order to provide the Agency with early notification of identified deficiencies in Recovery Act loans and with the loan approval process, the OIG issues Notices of Finding and Recommendation (NFR) related to the ongoing audit as problems are identified. The following two NFRs related to this audit were issued during December 2009.

- Recovery Act Loans Involving Change of Ownership Transactions. On December 2, 2009, the OIG issued an [NFR](#) that identified deficiencies in SBA's approval of 4 Recovery Act loans involving change of ownership transactions. The four loans totaled approximately \$2.1 million. One loan was not eligible for an SBA guaranty because it did not result in the borrower owning 100 percent of the business. Eligibility for the other three loans was questionable due to the excessive amount of goodwill financed in each transaction. The OIG found that SBA did not properly calculate the amount of goodwill funded by these three loans. Based on a statistical projection of these loans, the OIG projected that the Agency inappropriately approved at least \$6.6 million in SBA loans between February 17, 2009 and May 31, 2009. The OIG's recommends included provision of additional training to loan officers and a Quality Assurance Review process to measure the effectiveness of the training.

- Recovery Act Loans Disbursed Without Required Borrower Immigration Certifications. On December 10, 2009, the OIG issued an [NFR](#) that identified lender disbursements of Recovery Act loans that were made without obtaining the required borrower immigration certifications. The OIG found that 14, or 47 percent, of lender-approved loans reviewed did not contain the SBA-required borrower certifications. Based on a statistical projection of these loans, the OIG estimated that at least \$215 million in SBA Recovery Act loans were approved between February 17, 2009 and May 31, 2009, without obtaining the required borrower certifications of compliance with immigration laws. The OIG recommended that the Associate Administrator for Capital Access: (1) remind lenders to obtain borrower certification of compliance with immigration laws prior to loan disbursement; (2) require lenders to obtain borrower certifications for the 14 loans listed in the report; (3) flag the 14 loans listed in the report to ensure this deficiency is properly addressed at the time of guaranty purchase should these loans default; and (4) require lenders to submit borrower certifications of compliance with immigration laws at guaranty purchase, and cancel or reduce the SBA loan guaranties where lenders cannot furnish the required certification.

Review of Controls over Job Creation and Retention Statistics Reported by SBA under the American Recovery and Reinvestment Act of 2009. On December 4, 2009, the OIG issued a [report](#) on an initial review of the job creation and retention statistics reported by SBA under the Recovery Act. The Recovery Act provided SBA with \$730 million to expand the Agency's lending and investment programs and create new programs to stimulate lending to small businesses. The additional funding was intended to stimulate the economy by promoting job creation and

preserving existing jobs. SBA selected job creation and retention as one of its performance measures to assess the success of its Recovery Act programs. The OIG's review identified issues involving the reasonableness of reported job creation and retention statistics for loans approved in June 2009, which raised questions about whether SBA had the appropriate controls to ensure the integrity of its job data. The OIG estimated that the SBA-reported number of jobs created and/or retained may have been overstated by at least 16 percent. At the time of the audit, the June 2009 data was the only full month of Recovery Act data available for review. Job data was self-reported by borrowers on SBA 7(a) loan applications and submitted to SBA by lenders, who were not required to validate the borrower-reported information.

The report included recommendations that SBA's Associate Administrator for Capital Access implement necessary controls to check the reasonableness of job data and implement a data quality review and testing process to determine if job data is properly recorded, classified, and reported.

Inadequate Documentation to Support a Loan Approved Under Section 504 of the Recovery Act. Pursuant to the Chief Financial Officer's Act of 1990, an audit of SBA's FY 2009 financial statements was performed by KPMG LLP under a contract with the OIG. On December 15, 2009, an [NFR](#) was issued that identified a matter involving inadequate documentation to support a Section 504 debt refinancing approval that came to KPMG's attention during the financial statement audit. Specifically, KPMG noted that for one of the eight 504 program loans tested, the SBA supervisory loan specialist did not obtain a transcript of account or its equivalent prior to approval of the debt-refinancing transaction. The NFR included a recommendation that the Office of Financial Program Operations Director reinforce the importance of the transcript of account or equivalent document and ensure that the Supervisory Loan Officer properly verifies the accuracy and completeness of the Loan Officer's Report.

SBA's Administration of the Microloan Program under the Recovery Act. On December 28, 2009, the OIG issued a [report](#) on the results of the initial phase of an audit of SBA's administration of the Microloan program under the Recovery Act. Under the Recovery Act, SBA received \$6 million for direct loans and

\$24 million for the marketing, management, and technical assistance grants for the Microloan program. These funds were in addition to the \$22.5 million that SBA was appropriated for the Microloan program in FY 2009. The objectives for the initial phase of the audit were to determine the adequacy of SBA's (1) oversight of intermediaries, (2) performance data, and (3) program metrics for managing the Recovery Act funds authorized for the Microloan program.

The OIG found that SBA had not conducted adequate program oversight, validated the reliability of program data, accurately reported program performance, or established meaningful outcome-oriented performance measures. To ensure that microloans made with Recovery Act funds are properly monitored and the program has meaningful performance measures, the OIG recommended that SBA: (1) revise the review process to include an analysis of the sources and uses of the Microloan Revolving Fund and the Loan Loss Reserve Fund based on monthly financial statements; (2) examine, verify, and test microloan data in the Microloan Program Electronic Reporting System; (3) develop a staffing plan and hire and train the additional staff required to provide an adequate level of program oversight; (4) correct the processes for calculating the number of small businesses assisted and jobs created and retained should be corrected; (5) develop additional performance metrics; and (6) collect and analyze technical assistance data.

Indictment Unsealed in Loan Fraud Scheme. On October 23, 2009, a sealed indictment originally handed down on September 9, 2008, in the Southern District of Texas, was unsealed as it relates to 13 of 14 defendants. The indictment originally charged 14 individuals for their involvement in a complex loan fraud scheme. The individuals allegedly obtained numerous loans as a result of making false statements and submitting fraudulent documents to SBA-approved lending institutions. The defendants were charged with one or more counts of conspiracy to commit money laundering, conspiracy to commit wire fraud, and/or money laundering/aiding and abetting. Additionally, a criminal forfeiture count was included in the indictment in the amount of \$7,080,668.89. One of the defendants, a loan broker, pled guilty to one count of wire fraud on November 30, 2009. The investigation disclosed that he fraudulently represented himself as a licensed insurance agent by signing a letter to induce a lender to issue an \$870,000 SBA 7(a) guaranteed loan (which subsequently

defaulted). He also made fraudulent representations that induced two other financial institutions to wire transfer funds relating to residential mortgages. The OIG is conducting this investigation jointly with the Federal Bureau of Investigation (FBI) and the Internal Revenue Service, Criminal Investigations Division (IRS-CID).

Guilty Plea in Bank Fraud Investigation. On October 29, 2009, in U. S. District Court for the Eastern District of New York, a Turkish national pled guilty to 14 counts of bank fraud. He was previously indicted on 42 counts of bank fraud for fraudulently obtaining credit cards and loans from various financial institutions. The investigation revealed that an organized group of Turkish nationals were obtaining credit cards and loans from various financial institutions using false identities, documents, and businesses. Thirty SBAExpress loans, totaling approximately \$1.2 million, have been linked with this group, and a large percentage of these loans are in default. This guilty plea involved six SBAExpress loans totaling \$290,000. The OIG is conducting this jointly with the U.S. Postal Inspection Service.

Disaster Loans

Louisiana Man Indicted for Theft of Government Funds. On December 3, 2009, a Louisiana man was charged via a criminal information in the Eastern District of Louisiana with two counts of theft of government funds. The investigation alleges that he made false statements and submitted altered and fictitious documents to SBA in order to receive a \$68,400 disaster home loan and a \$70,000 disaster business loan. He allegedly misrepresented that his used auto dealership was reopening in order to entice SBA to disburse disaster business loan funds. The investigation revealed that the State of Louisiana had revoked the dealership's license. The OIG is conducting this investigation jointly with the FBI.

Guilty Plea for Theft of Government Funds. On December 17, 2009, a Louisiana woman was sentenced in U.S. District Court, Eastern District of Louisiana, to 3 years probation, restitution of \$16,729.95, and a special assessment fee of \$100. She previously pled guilty to a one-count information charging her with theft of government funds. The investigation revealed that she received a \$77,200 physical disaster loan from SBA and then misused the loan funds. SBA disbursed the disaster loan funds

based upon what turned out to be false, fictitious, and fraudulent construction contracts and purchase receipts, as well as altered quotes for work and purchases. The investigation also determined that she completed an SBA Assignment of Insurance Proceeds form and then hid from SBA the additional insurance proceeds that were paid to her.

Guilty Pleas in Theft of Government Funds. On December 17, 2009, a Louisiana woman pled guilty in U.S. District Court, Eastern District of Louisiana, to two counts of theft of government funds. Her husband pled guilty to one count of misprision of a felony for concealing knowledge of his wife's felony. The guilty pleas related to misrepresentation of damage to their family home after Hurricane Katrina and use of loan proceeds for reasons other than making repairs to the home. The couple was approved for an SBA disaster loan in the amount of \$38,800 and a Louisiana Road Home (LRH) grant in the amount of \$150,000. The investigation disclosed that altered, false, fictitious and fraudulent contractor receipts and statements of work were submitted in support of SBA disaster loan disbursements, and false statements regarding damages and related repairs were made in support of LRH disbursements. The SBA OIG is conducting this investigation jointly with the U.S. Department of Housing and Urban Development OIG.

Surety Bond Guarantees

Lack of Approval for a Recovery Act Surety Bond Guaranty. Pursuant to the Chief Financial Officer's Act of 1990, an audit of SBA's FY 2009 financial statements was performed by KPMG LLP under a contract with the OIG. On December 15, 2009, an [NFR](#) was issued that identified a matter involving the approval of a surety bond guaranty that came to KPMG's attention during the financial statement audit. Specifically, KPMG noted that a surety bid bond was erroneously approved and not canceled prior to its audit work. The surety bid bond was approved by a preferred surety company through the Surety Bond Guaranty (SBG) System. However, when KPMG requested the supporting approval documentation, the surety company stated that the bid bond was recorded in error and should be canceled. The surety company explained that the contractor did not complete SBA Form 994, Application for Surety Bond Assistance, and ultimately did not bid on the job. The NFR recommended that SBA's Office of Capital Access continue to monitor preferred sureties to ensure all

required documentation supporting bid bond approvals is maintained and to develop and implement policies and procedures to monitor aged outstanding Preferred Surety Bond bid bond approvals.

Agency Management

Recovery Act Payroll Processing and Accounting.

Pursuant to the Chief Financial Officer's Act of 1990, an audit of SBA's FY 2009 financial statements was performed by KPMG LLP under a contract with the OIG. On December 15, 2009, two NFRs were issued that identified issues involving Recovery Act payroll [processing](#) and [accounting](#) that came to KPMG's attention during the financial statement audit. These issues included an employee being compensated based on an incorrect salary grade and payroll expense for 20 Recovery Act employees being incorrectly charged to non-Recovery Act funds. The NFR included recommendations for improving internal controls over payroll processing and accounting.

Audit of SBA's FY 2009 Financial Statements –

Management Letter. Pursuant to the Chief Financial Officer's Act of 1990, an audit of SBA's FY 2009 financial statements was performed by KPMG LLP under a contract with the OIG. The independent auditor's report was issued on November 14, 2008. On December 15, 2009, KPMG issued a [Management Letter](#) addressing internal control and other operational matters that were noted during the audit, but were not considered to be reportable conditions. KPMG's comments and recommendations, all of which were discussed with the appropriate members of management, are intended to improve internal control or result in other operating efficiencies.

This monthly update is produced by the SBA OIG, Peggy E. Gustafson, Inspector General.

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