



Office of Inspector General U.S. Small Business Administration

January 2010 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 NFR related to this audit was issued on January 22, 2010.

- Notice of Finding and Recommendation on Ineligible Lender-Approved Recovery Act Loans. The OIG reviewed a sample of 30 Recovery Act loans approved by lenders between February 17 and May 31, 2009, and determined that 3 of the loans were not eligible for SBA guaranties. One lender canceled a portion of an SBA-guaranteed loan approved prior to the Recovery Act and, without SBA approval, reissued it as a Recovery Act loan with a higher SBA guaranty. A second loan was ineligible for an SBA guaranty because (1) it resulted in the borrower's maximum outstanding loan balance exceeding the SBA limit, and (2) the interest rate on the loan was in excess of that allowed by SBA. Finally, a third loan was not eligible for an SBA guaranty because the lender did not comply with SBA's change of ownership requirements. Specifically, the lender did not (1) perform a business valuation, (2) conduct a site visit of the assets being purchased, or (3) verify the seller's financial information. Based on the results for the 30 loans in the sample, the OIG estimated that lenders inappropriately approved at least 63 SBA-guaranteed loans between February 17 and May 31, 2009. If the loans are not brought into compliance with SBA

requirements, the lenders risk losing their SBA guaranties.

The OIG recommended that SBA (1) require the lenders to bring each of the three loans into compliance, or, if not possible, cancel or adjust the SBA guaranties accordingly, and (2) provide training to the lenders to prevent similar instances of noncompliance. The Agency agreed that all three loans had issues that could affect their eligibility under SBA policies and procedures and stated that it would (1) work with the lenders to determine if any adjustments were necessary and (2) provide training to the lenders on the issues identified in the NFR.

Louisiana Corporation Enters Guilty Plea. On January 19, 2010, a petroleum company (a Louisiana corporation) pled guilty in the Eastern District of Texas to one count of money laundering and was ordered to pay a \$200,000 fine. The investigation revealed that the company falsified the true source of funds to support its required \$120,000 equity injection in order to secure a \$480,000 SBA-guaranteed loan to purchase property. Prior to receiving the loan, representatives of the company provided documentation purporting to show that it had met the condition of providing an equity injection of \$120,000 of the company's own money in support of the loan. These representations were knowingly false; the company never had the required equity injection funds. Instead, the \$120,000 was actually loaned to company by the seller of the property. The OIG is conducting this investigation jointly with the Internal Revenue Service, Criminal Investigations Division.

Illinois Man Sentenced. On January 22, 2010, in the Southern District of Iowa, an Illinois man was sentenced to 2 years imprisonment, 3 years supervised release, and was ordered to pay \$2,008,964 in restitution. He had previously pled guilty to one count

of making a false statement in connection with a scheme to induce a lender to approve three separate loans (including an SBA guaranteed loan) totaling more than \$4 million to purchase three Iowa gas stations. The investigation revealed that that the individual, together with another man, enlisted “front” borrowers and provided the lender with false and fraudulent documentation on behalf of the borrowers in order to influence the approval of the three loans. The second individual previously pled guilty in the Northern District of Illinois after being charged in relation to this matter. The OIG is conducting this investigation jointly with the Federal Bureau of Investigation (FBI).

Disaster Loans

Louisiana Man Charged. On January 13, 2010, in the Eastern District of Louisiana, an individual was charged via a criminal information with two counts of theft of government funds. It is alleged that he filed an application for an SBA Katrina disaster assistance loan using an address that was not his primary residence when the hurricane struck New Orleans. It is also alleged that he submitted fraudulent receipts to induce SBA to approve the loan. The loan was originally approved for \$117,000; however, only \$50,000 of the loan was actually disbursed. The individual also received \$56,000 in Louisiana Road Home Program grant funds by using the same address. The SBA OIG is conducting this investigation jointly with the Department of Housing and Urban Development OIG.

Louisiana Man Pleads Guilty. On January 20, 2010, in the Eastern District of Louisiana, an individual pled guilty to two counts of theft of government funds. The investigation disclosed that he made false statements and submitted altered and fictitious documents to SBA in order to receive a disaster home loan of \$68,400 and a disaster business loan of \$70,000. After the loans were approved, he submitted altered and fictitious contracts and invoices for home repairs purporting to show that the work had been completed in order to obtain disbursement of the loan funds. In addition, he misrepresented that his used car dealership was reopening in order to obtain disbursement of the disaster business loan funds. The investigation revealed that the State of Louisiana had revoked his auto dealership license. The OIG is conducting this investigation jointly with the FBI.

Florida Woman Sentenced. On January 25, 2010, a woman was sentenced in U.S. District Court for the Middle District of Florida to 15 months in prison, 5 years supervised release, \$97,008 in restitution, and a \$400 special assessment fee. The court also entered a judgment requiring her to forfeit \$55,000 in assets, to go toward payment of the restitution. She previously pled guilty to making a false statement to the SBA; making false statements to a federally insured financial institution; and unlawful disclosure and use of a Social Security account number (SSN). The charges relate to her using her sister’s SSN without her authorization to secure a \$41,700 SBA disaster business loan; a \$25,000 SBAExpress guaranteed loan through a lender; and a \$30,000 business line of credit through another lender. The SBA disaster business loan was to be used as working capital for her company in order to alleviate economic injury caused by Hurricane Wilma in October 2005. The OIG is conducting this investigation jointly with the Naples (Florida) Police Department, the Social Security Administration OIG, and the U.S. Postal Inspection Service.

Government Contracting and Business Development

Report on SBA Regulations Relating to Unconditional Ownership Requirements for Indian Tribes. On January 25, 2010, the OIG issued a report regarding an issue that arose during a review of a tribally-owned 8(a) firm. During the course of the review, the OIG determined that SBA’s business development regulations do not clearly implement the Small Business Act’s statutory requirement that firms owned by Indian tribes be unconditionally owned. In addition, SBA’s regulatory definition of unconditional ownership appears to be inconsistent with restrictions discussed in the legislative history of the Act.

The Small Business Act requires that small business concerns be at least 51 percent unconditionally owned or controlled by a socially or economically disadvantaged individual or Indian tribe. The purpose of unconditional ownership is to ensure that disadvantaged owners are the primary beneficiaries of the 8(a) program. Under SBA’s regulations, however, Indian tribes are not subject to the unconditional ownership requirement.

The tribally-owned 8(a) firm reviewed by the OIG was started with self-valued goodwill representing the value of the expertise and contacts of a non-disadvantaged individual (NDI). The NDI contributed 49 percent of the goodwill to the 8(a) firm. The remaining goodwill was sold to the Indian tribe to be contributed to the formation of the 8(a) firm, and the tribe agreed to pay for the goodwill from its share of future profits from the firm. Although the NDI's company and the tribe agreed that the tribe would own 51 percent of the 8(a) firm, this seller-financed transaction effectively reduced the tribe's share of profits to 25 percent, while the NDI's company received 75 percent.

The OIG recommended that SBA revise its regulations to mandate that tribally-owned firms be unconditionally owned, as required by the Small Business Act. The OIG also recommended that SBA study the effect of allowing seller-financed transactions to encumber ownership shares and, if appropriate, revise its regulations to provide that stock or other ownership interest pledged or encumbered not qualify as unconditional ownership unless the pledge or encumbrance occurs within an arms-length transaction with a legitimate financial institution.

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

The 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 these documents please contact:

SBA OIG
409 Third Street SW., 7th Floor
Washington, DC 20416
E-mail: oig@sba.gov
Telephone number (202) 205-6586
FAX number (202) 205-7382

Many OIG reports can be found on the OIG's website at:

www.sba.gov/ig

If you are aware of suspected waste, fraud, or abuse in any SBA program, please report it online at:

www.sba.gov/ig/aboutus/overview/rsw/index.html

Or call the OIG Hotline toll-free at (800) 767-0385