



Office of Inspector General U.S. Small Business Administration

September/October 2009 Update

Disaster Loan Program

Monitoring of Insurance Coverage for Disaster Loan Recipients. On October 20, 2009, the OIG issued a report on an audit of SBA's monitoring of insurance coverage for disaster loan recipients. The purpose of the audit was to determine whether SBA's disaster loan servicing centers adequately monitored required insurance coverage on properties collateralized by SBA disaster loans.

Based on review of a statistical sample of fully-disbursed disaster loans resulting from the Gulf Coast hurricanes in 2005, Hurricanes Ike and Gustav in 2008, and the Midwest floods in 2008, the OIG found that SBA did not ensure that borrower insurance policies provided adequate coverage and were continuously reviewed. The Agency also did not comply with statutory requirements to purchase policies for borrowers who let their policies lapse. As a result, \$3.8 million in outstanding loan balances for loans in the sample may not have been adequately protected. Projecting the sample results to the universe of 23,068 fully-disbursed loans from the above disasters, the OIG estimated that at least 5,341 loans, with approximately \$510 million in outstanding loan balances, lacked evidence of adequate insurance coverage. Similar non-compliance rates may exist for loans associated with other major disasters.

SBA's Office of Financial Assistance indicated that the Agency's loan servicing centers discontinued all insurance monitoring activities 23 years ago based on a 1986 memo that allowed such activities to be suspended during periods of high workloads and low staffing levels. Consequently, the loan servicing centers have not tracked insurance coverage on collateral properties or enforced insurance requirements on non-compliant borrowers, and policy

documents provided by insurance providers have been discarded without being reviewed. This conflicts with

the Flood Disaster Protection Act and SBA standard operating procedures that require flood insurance policies to be purchased for non-compliant borrowers with collateral properties located in Special Hazard Flood Areas.

The OIG recommended that SBA inform borrowers on loans identified by the OIG as having lapsed policies or insufficient insurance coverage that they must provide evidence of adequate insurance coverage. The OIG also recommended that SBA determine what actions are needed to achieve compliance with statutory flood insurance requirements, as well as the cost implications of achieving compliance, and develop and execute a plan for achieving compliance on existing and future loans. If achieving compliance is determined not to be cost effective, the Agency should take steps to seek additional funding or a legislative change to this requirement.

Application of Insurance Offsets for Gulf Coast Disaster Loans. On October 21, 2009, the OIG issued a report on an audit of the application of insurance offsets for Gulf Coast hurricane disaster loans. The purpose of the audit was to determine whether SBA properly reduced loan balances to reflect flood and hazard insurance offsets. Under the Stafford Act, Federal agencies administering disaster benefits must ensure that individuals receiving assistance have not already been compensated for their losses from insurance or other sources.

An OIG review of a statistical sample of 100 Gulf Coast hurricane loans, totaling nearly \$6 million, found that SBA did not correctly identify or offset insurance payments on 21 of these loans, resulting in \$385,610 of offset errors, primarily duplicate benefits.

The majority of the errors occurred because loan officers did not check with insurance companies prior to each disbursement to determine the amount of insurance that had been paid, as required. Based on the sample results, the OIG projected that SBA did not appropriately adjust loan eligibility by at least \$80.2 million in insurance recoveries, of which at least \$20.3 million were duplicate benefits, for 119,162 Gulf Coast hurricane loans disbursed between October 2005 and October 2007.

In response to the audit, SBA addressed 19 of the 21 exceptions. The OIG recommended that the Agency resolve the two remaining exceptions, totaling \$44,481, and that it develop a corrective action plan to identify and address the offset errors present in the remaining universe of Gulf Coast hurricane disaster loans. The OIG also recommended that the Agency implement procedures to require timely re-verification of insurance recoveries during the servicing of loans. In response to a prior OIG audit of insurance offsets related to the 2008 Midwest floods, SBA previously agreed to revise its standard operating procedures to require confirmation of all insurance recovery amounts prior to loan approval and before each loan disbursement.

Louisiana Woman Sentenced. On October 7, 2009, a Louisiana resident was sentenced to 69 months in federal prison, 3 years supervised release, restitution of \$156,761, and a special assessment fee of \$500. She was previously convicted of two counts of theft of Government funds, two counts of false statements, and one count of wire fraud. The woman submitted an application to the SBA for a Hurricane Katrina physical disaster loan for property that she falsely claimed she owned. She also submitted a fraudulent quitclaim deed stating that she had acquired the property from the City of New Orleans in exchange for the back taxes owed on the property. In addition to receiving \$75,000 from SBA, she applied to the Louisiana Road Home program using the same property address and quitclaim deed, receiving \$132,000 from that program. The SBA OIG is conducting this investigation jointly with the Federal Bureau of Investigation (FBI) and the Department Housing and Urban Development (HUD) OIG.

Florida Woman Pleads Guilty. On October 7, 2009, a Florida woman plead guilty in U.S. District Court for the Middle District of Florida 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). She used her sister's SSN without her authorization to secure a \$41,700 disaster business loan, a \$25,000 SBAExpress guaranteed loan, and a \$30,000 business line of credit. The SBA disaster loan was to be used as working capital for her company in order to alleviate economic injury caused by Hurricane Wilma in October 2005. This investigation is being conducted jointly with the Naples Police Department, the Social Security Administration OIG, and the U.S. Postal Inspection Service.

Mississippi Couple Indicted. On September 3, 2009, a Mississippi couple was indicted in U.S. District Court for the Southern District of Mississippi on one count of false or fraudulent claims, four counts of false statements, two counts of false statements in loan applications, and two counts of theft of public money, property, or records. They were approved for an SBA disaster loan in the amount of \$240,000 for property they owned in Ocean Springs, Mississippi. The couple claimed the property was their primary residence on August 29, 2005, when Hurricane Katrina hit the Gulf Coast; however, at the time they were actually living in California. The couple received loan payments in the amount of \$50,000. The SBA OIG is conducting this investigation jointly with the HUD OIG, the Department of Homeland Security (DHS) OIG, and the Mississippi State Auditor's Office.

Louisiana Woman Pleads Guilty. On September 24, 2009, a Louisiana woman pled guilty in U.S. District Court for the Eastern District of Louisiana to one-count of theft of government funds for misuse of proceeds from a \$77,200 SBA disaster loan. In support of loan disbursements, she submitted false, fictitious, and fraudulent construction contracts and purchase receipts, as well as altered quotes for work and purchases. She also failed to disclose additional insurance proceeds that had been paid to her.

Louisiana Man Pleads Guilty. On September 16, 2009, a Louisiana man pled guilty in U.S. District Court for the Eastern District of Louisiana to one count of theft of public funds. He misrepresented to the SBA that he had contracted for repairs to his residence for damages caused by Hurricane Katrina when, in fact, he had only received an estimate for the repairs. Based on the misleading documentation, SBA approved a disaster loan in the amount of \$106,300. He also submitted three fictitious checks to the SBA to

falsely show that renovations were performed on his property. The SBA OIG is conducting this investigation jointly with the U.S. Department of Agriculture OIG.

Business Loan Programs

Businessman Pleads Guilty. On October 23, 2009, the former owner of a defunct disaster restoration contractor in Longview, Washington, was charged in the U.S. District Court, Western District of Washington, with one count of mail fraud, one count of bank fraud, one count of money laundering, and criminal forfeiture. On the same day, he pled guilty to the charges and agreed to the forfeiture. Over several years, he submitted inflated and/or falsified invoices and false competitors' estimates to an insurance company for disaster restoration work that his company performed. As a result, the company received more than \$3 million in excess payments and its financial statements reflected highly inflated profits. When the business was subsequently sold, the buyer obtained a \$1,999,800 SBA-guaranteed loan to fund a portion of the sale and the inflated financial statements were submitted to support the value of the business and the purchase price. The man then used the fraudulently obtained loan proceeds to purchase a \$1.785 million home in Florida, which he agreed to criminally forfeit. This ongoing investigation is being conducted jointly with the Internal Revenue Service (IRS) Criminal Investigations Division (CID).

Results of Ongoing Investigation. The following case is part of an ongoing investigation, being conducted jointly with the U.S. Secret Service (USSS), relating to a scheme in which a non-bank lender's former executive vice president and others not employed by the lender conspired to fraudulently qualify loan applicants for SBA-guaranteed loans.

- On October 22, 2009, a Michigan man pled guilty to conspiracy to commit wire fraud. He and a co-conspirator were previously charged with conspiracy, conspiracy to commit wire fraud, false statements, and aiding and abetting for falsifying equity injections and loan disbursements on HUD settlement statements involving twelve SBA-guaranteed loans. The man acted as a broker to recruit "straw buyers" to falsely obtain SBA-guaranteed loans. The co-conspirator, an escrow agent, conducted the loan closings. Upon completion of closings, the fraudulently obtained loan proceeds were wired from the lender to

accounts held by the co-conspirator's escrow companies. The SBA OIG is conducting this investigation in conjunction with the United States Secret Service. Prosecution of the co-conspirator is continuing, with additional indictments expected.

Maryland Business Owner Charged. On September 17, 2009, in the U.S. District Court for the District of Maryland, the owner of a restaurant equipment company in Cambridge, Maryland, was charged with one count of conspiracy. The investigation disclosed that she entered into an agreement with the owner of a Lusby, Maryland restaurant to provide equipment and perform construction/renovation work at a total cost of \$145,000. It is alleged that, at the request of the restaurant owner, she falsely represented the total cost of the project to be \$295,000 and submitted a copy of the false contract to an SBA lender. The restaurant owner then obtained an SBA-guaranteed loan in the amount of \$417,000. The restaurant owner was previously charged in this case.

Government Contracting and Business Development

Businessman Sentenced. On October 22, 2009, in the U.S. District Court for the District of Maryland, a former Occupational Health and Safety Coordinator of the West Virginia Department of Administration (WVDA) was sentenced to 12 months and one day incarceration, 6 months home confinement, 3 years supervised release, a \$3,000 fine and a \$100 special assessment fee. He admitted that he caused a check to be mailed through the U.S. Postal Service from the WVDA to an environmental and demolition services company (a former SBA 8(a) certified firm) in Baltimore, Maryland, as payment for lead abatement work on a West Virginia state contract with the intent to promote the unlawful activity of accepting a gratuity in violation of the West Virginia Bribery and Corrupt Practices Act. He provided the company with confidential bid information, which enabled it to be the lowest bidder on contracts, and then awarded contracts to the company in return for money and other things of value. The SBA OIG is conducting this investigation jointly with the Environment Protection Agency (EPA) CID, the Naval Criminal Investigative Service (NCIS), the IRS CID, and the FBI.

Maryland Accountant Sentenced. On October 23, 2009, in the U.S. District Court for the District of Maryland, an accountant for the environmental and demolition services company in the preceding case, was sentenced to 30 days in jail, 5 months home confinement, and 1 year probation. In addition, she was ordered to pay \$33,624 in restitution to the IRS and a \$100 special assessment fee. She was previously pled guilty to one count of providing false statements on an income tax return to the IRS. The accountant embezzled \$125,370.54 from the environmental and demolition services company and then omitted the amount as taxable income on her income tax return. This violation was discovered during the investigation discussed above. This joint investigation continues with the EPA CID, NCIS, IRS CID, and the FBI.

Indefinite Suspensions Issued. On September 23, 2009, the U.S. Air Force issued indefinite suspensions to 19 companies and 4 individuals affiliated with a subsidiary of an Alaskan Native Corporation (ANC). The suspension actions stemmed from a multi-agency investigation of a conspiracy by the principals of the subsidiary and its numerous business entities to defraud the SBA and the U.S. Defense Department by failing to divulge business and ownership agreements in order to gain SBA's preferential treatment of small businesses under its 8(a) program. The SBA OIG is conducting this investigation jointly with the Defense Criminal Investigative Service, the U.S. Army Criminal Investigation Command, the U.S. Air Force Office of Special Investigations, the NCIS, and the IRS CID.

Agency Management

Assessment of SBA Readiness to Review Recipient Reports on the Use of Recovery Act Funds. On October 30, 2009, the OIG issued the results of a review of SBA's plans for ensuring that recipients of American Recovery and Reinvestment Act (Recovery Act) funds submit accurate, complete, and timely data on the use of the funds, as required by Section 1512 of the Recovery Act. Guidance issued by the Office of Management and Budget (OMB) requires Federal agencies are to perform limited data quality reviews of recipient information and notify the recipients of two key data problems – material omissions and significant reporting errors.

For SBA, Section 1512 reporting requirements apply only to the Agency's contract awards, the Microloan Program, and the 7(a) Broker/Dealer Direct Loan Program. As of September 30, 2009, SBA had issued 15 Recovery Act-related contracts totaling \$5.8 million and had obligated \$15 million in Recovery Act funds for the Microloan Program. It had not yet implemented the 7(a) Broker Dealer Direct Loan Program.

The OIG found that SBA had established processes for performing data quality reviews for contract and Microloan recipient data and for notifying recipients of the need to make appropriate and timely changes. However, the Agency had not adequately defined the review process it would use to identify material omissions and/or significant reporting errors in contract recipient data, and had not yet drafted a policy for reviewing Microloan recipient data. The OIG recommended that SBA issue detailed procedures for performing data quality reviews over contract recipient reports and define its process for reviewing Microloan intermediary reports.

This monthly update is produced by the SBA OIG,
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