



Office of Inspector General U.S. Small Business Administration

April 2004 Update

Agency Management

The OIG Issues Audit Report on Loan Application Tracking System. On April 5, 2004, the OIG issued an audit report on SBA's Loan Application Tracking System (LATS). The objective of the audit was to perform an application control review using the Federal Information Systems Controls Audit Manual (FISCAM) on the LATS, a subsystem of the Loan Accounting System (LAS), in the following areas: authorization controls; completeness controls; accuracy controls; and controls over integrity of processing and data files.

The audit disclosed that SBA's LATS system generally had adequate application controls. However, LATS transactions were not secure from unauthorized access in that controls could be circumvented if the computer was not physically secure. Additionally, the LAS was not properly owned and did not have changes controlled through a Configuration Control Board (CCB). We made three recommendations to correct the control weaknesses identified in the report. The Chief Operating Officer/Chief Information Officer and the Chief Financial Officer agreed with the recommendations.

The OIG Issues Audit Report on SBA's Information Systems Controls. On April 29, 1994, the OIG issued an audit report on SBA's Information Systems Controls – FY 2003, prepared by Cotton & Company LLC. As part of the annual financial statement audit, the auditors reviewed general and application controls over SBA's financial management systems to determine compliance with various Federal requirements. The auditors concluded again, as they did for FY 2002, that SBA made progress toward implementing an agency-wide systems security program, but that improvements are still needed.

The report describes areas where controls can be strengthened in general control areas, including: 1) entity-wide security program controls; 2) access controls; 3) application software development and program change controls; 4) system software controls; 5) segregation of duty controls; and 6) service continuity controls. The Chief Operating Officer/Chief Information Officer and the Chief

Financial Officer provided separate responses to the draft report. SBA management agreed with 16 of the 17 recommendations and partially agreed with the remaining recommendation.

Agency Completes Five Final Actions on the Audit of SBA's FY 2003 Financial Statements – Management Letter. As a result of the audit, the following five final actions have been completed: 1) the Agency developed a plan for FY 2004 reporting that includes an appropriate timeline for performance data measures gathering, summarization, quality assurance, and auditor review; 2) the Office of the Chief Financial Officer's (OCFO) Office of Financial Systems, in conjunction with the Office of the Chief Information Officer (OCIO), has overcome all the data query and balancing issues and is now loading allotments at a very detailed point break level into the Financial Reporting Information System (FRIS); 3) a report of outstanding collateral purchase (COLPUR) items was distributed to field offices for their certification of the asset value (the end-of-year Federal Managers Financial Integrity Act assurance letters were modified to include a statement on COLPUR management); 4) a mathematical error in converting quarterly to monthly probabilities in the 7(a) secondary market guarantee model has been corrected; and 5) the Agency developed procedures to ensure that travel authorizations (obligations) are fully recorded in oracle, thus utilizing automated funds controls at all times, including periods of continuing resolution.

Agency Completes Two Final Actions on Audit of SBA's Administration of the Procurement Activities of Asset Sale Due Diligence Contracts and Task Orders. The following two final actions have been completed: 1) the Agency has agreed to keep written records of the activities conducted, and suitable records will be maintained if due diligence contractors are hired, and 2) the Agency has developed an online Freedom of Information Act (FOIA) training guide for SBA employees.

Business Loan Programs

Colorado Business Owner Sentenced. On March 19, 2004, a Berthoud, Colorado, business owner was sentenced to 6 months incarceration, 3 years supervised

release, and ordered to pay an assessment fee of \$200. The owner previously pled guilty on October 20, 2003, to one count of **bankruptcy fraud** and one count of **conspiracy**. The SBA OIG joint investigation with the Federal Bureau of Investigation (FBI) revealed that, shortly after his wife received a \$100,000 SBA guaranteed LowDoc loan, she defaulted and filed for bankruptcy. They conspired to hide assets in excess of \$25,000 from the bankruptcy court and SBA. This investigation was initiated based on a referral from the Colorado District Office.

Puerto Rico Nursing Home Owner Makes Final Payment on Pre-Trial Diversion Agreement. The owner of a nursing home in San Juan, Puerto Rico, paid \$305,981, which represents the final payment of his **pre-trial diversion agreement**, dated January 31, 2003. As part of the pre-trial diversion agreement, the owner made previous payments totaling \$63,649 between April 8, 2003, and December 29, 2003. In addition, on March 29, 2004, he also paid off the interim financing portion of his SBA 504 loan in the amount of \$231,980. As a result of the investigation, he has paid a total of \$601,611 to SBA and the financial institution. The owner received an SBA 504 loan totaling \$946,000, wherein SBA's debenture portion of the loan was \$391,000. The loan was to be used to purchase and remodel real estate, and to purchase machinery/equipment for his business. The investigation revealed that he submitted a false real estate purchase agreement between himself and another individual. He paid the individual \$20,000 to pose as the president of the nursing home so that his 504 loan could be approved. This investigation was initiated based on a referral from private individuals. The SBA OIG conducted this ongoing investigation jointly with the FBI.

Two Massachusetts Individuals Convicted of Fraud. On April 21, 2004, two individuals were convicted on seven counts related to **fraud** involving an intermediary in SBA's Microloan Program. The intermediary had been established to administer low interest loan funds to promote additional capital investment and job creation in the City of Springfield, Massachusetts. One individual served as the fund's accountant and prepared its annual audits. He was convicted on one count of **conspiracy** and three counts of **false statements** for submitting audits to SBA that concealed various conflicts of interest, inappropriate use of Government funds for recreational travel, and bogus consulting businesses set up by the fund's administrators to siphon grant monies. The second individual, who served on the intermediary's board of directors, was convicted on one count of **conspiracy** and two counts of **theft** from a Government program. He received a \$25,000 consulting "fee" after the intermediary sold seven loans funded by the Department of Commerce on the secondary market.

In an earlier plea agreement for this case, co-administrators of the intermediary entered guilty pleas for their roles in this fraud. One administrator pled guilty to **conspiracy, program fraud, and money laundering**. The other administrator pled guilty to **conspiracy, program fraud, false entries** (15 USC 645(b)), and **money laundering**. The co-administrators paid themselves more than \$300,000 in unauthorized "consulting" and "technical assistance" fees between 1998 and their resignations in June 2002. They attempted to hide the transactions by paying the fees to two shell companies they had created. They also improperly used intermediary funds for approximately \$170,000 in "recreational travel" for a number of trips that included Cancun, Hawaii, the Bahamas, and Las Vegas. They also forged the signatures of unsuspecting board members on checks used to pay for meals and hotels in an attempt to make them appear legitimate.

Texas Convenience Store and Service Station Proprietor Pleads Guilty. The proprietor of a convenience store and service station in North Richland Hills, Texas, pled guilty on March 8, 2003, on one count of making a **false statement** to SBA, a violation of Title 15 USC 645. The proprietor was indicted for inducing a bank and the SBA into funding a \$1,200,000 SBA guaranteed-loan by falsely representing to be a U.S. citizen on SBA Form 912. He was sentenced to time served, supervised release for 1 year, and a \$500 fine. Upon his release from prison, he was required to surrender to an immigration official for deportation. The OIG conducted this continuing investigation jointly with Department of Homeland Security, Social Security Administration, Department of Agriculture, Texas Department of Public Safety and the Texas Alcoholic Beverage Commission.

Former President of a Food Manufacturer Charged With an Information. On April 16, 2004, the former president of a food manufacturing business formerly located in Portsmouth, Ohio, was charged with one count of **Accessory After the Fact**, via an **Information** filed in the Southern District of Ohio. The former president was charged for her involvement in a scheme to defraud the SBA and a participating lender in connection with an April 1995, \$700,000 loan. The former president and her spouse, the manager of the business, provided personal guaranties to obtain the loan. The SBA OIG investigation revealed that they formed two shell corporations for the purposes of concealing the purchase of substandard machinery and equipment and their theft of loan proceeds. After the loan closing, their business and the two shell corporations submitted correspondence and false invoices to the SBA and the bank detailing fabricated sales agreements, including grossly inflated purchase amounts. The false documents also listed fictitious addresses and telephone numbers, which actually belonged to friends and acquaintances. The proceeds from these fraudulent sales were then laundered through bank accounts held in the names of the shell corporations and converted for their personal use. The

SBA OIG conducted this investigation based on a referral from the SBA's Columbus District Office.

Former California SBA Bank Department Manager Arrested. On April 1, 2004, SBA Special Agents and the Glendale Police Department arrested a former SBA bank department manager, in Duarte, California. The arrest was pursuant to an outstanding bench warrant issued by the Clark County District Attorney's Office, Las Vegas, Nevada. The warrant stemmed from five counts of **drawing and passing a check without sufficient funds with intent to defraud**. The criminal complaint filed against her included \$28,000 in bad checks written to Caesar's Palace Hotel and Casino. Allegedly, the bank manager told an SBA borrower to make a \$14,000 cash payment towards his SBA loan. The bank manager used the cash to pay her personal gambling debts. When the borrower found out that the money was not credited to his SBA loan, he demanded an explanation from her. The bank manager admitted taking the money and using it to pay her gambling debts. She promised to repay the lender, but instead wrote \$14,000 worth of bad checks to the borrower. As a result, the borrower's SBA loan went into default and was ultimately charged off as a loss to the bank and the SBA. The investigation was initiated based on a routine criminal history check of the bank manager through the SBA OIG Office of Security Operations, which revealed an outstanding arrest warrant.

Three Final Actions Completed on Audit of Georgia District Office Sponsorship Events. The following three final actions have been completed: 1) the Agency issued a procedural notice to all district directors, district counsels, and all district office administrative officers, announcing SBA procedures for depositing cash gift funds, expenditure of funds, and requirements for tracking expenditures to/from the business assistance trust fund; 2) the Agency issued instructions concerning the appropriate procedures for planning and conducting cosponsored and SBA-sponsored events; and 3) the Agency provided the district director and the district counsel with sufficient guidance, available on-line in the SBA Outreach Handbook, to ensure that registration issues do occur in the future.

Disaster Loan Program

Former New York Attorney Arrested for Wire Fraud and Money Laundering. On April 22, 2004, a former attorney was arrested in the Southern District of New York, pursuant to a complaint accusing him of **wire fraud and money laundering**. In the wake of the September 11, 2001, terrorist attacks in New York City, the former attorney applied for and received a \$247,000 SBA disaster loan. The former attorney claimed that his firm had been located at 40

Wall Street in downtown New York City on September 11, 2001. The investigation revealed that his firm was never located at that address. The former attorney was arrested by SBA Special Agents and the Internal Revenue Service (IRS), with whom this case is being investigated jointly. The case was referred to the SBA OIG by an attorney on the Grievance Committee of the 9th Judicial District of New York State.

Government Contracting and Business Development Programs

Former Pennsylvania 8(a) Program Participant Sentenced. On April 1, 2004, a former SBA 8(a) program participant in Philadelphia, Pennsylvania, was sentenced to 5 years probation and a \$200 special assessment fee. Also, as a condition of his probation, he must continue to make restitution to the bonding company pursuant to a \$500,000 settlement agreement, which was a principal condition of his guilty plea. Previously, he pled guilty to one count of **conspiracy** and one count of **mail fraud**. The **conspiracy** count related to false statements he made to the SBA that another individual controlled the construction company, when in fact he ran the company. They obtained bonding for the company through an independent agent. The **mail fraud** count related to fictitious financial statements mailed from the independent agent to the bonding company. The bonding company relied on the false financial statements to issue bonding to the construction company. As a result of the company's defaults on contracts, the bonding company paid more than \$2.9 million in payment bonds and incurred an additional \$3 million in losses on performance bonds to have the contracts completed. The SBA OIG conducted this joint investigation with the Naval Criminal Investigative Service (NCIS), Department of Veterans Affairs OIG, and the Defense Criminal Investigative Service (DCIS).

Colorado Business Owner Pleads Guilty. A co-founder of an Englewood, Colorado, business pled guilty on April 22, 2004, to one count of **concealing assets** from the bankruptcy court, one count of **money laundering**, and one count of **criminal forfeiture**. The business owner was previously indicted by a Federal Grand Jury in Denver, Colorado, on two counts of **bankruptcy fraud**, 87 counts of **concealing assets**, 2 counts of **money laundering**, and 1 count of **criminal forfeiture**. The SBA OIG joint investigation with the IRS, FBI, and DCIS disclosed that the business was a certified SBA 8(a) company which sold computer equipment to the U.S. Government and was primarily controlled by a non-minority. The business owner, while an officer of the company, declared personal bankruptcy and received a discharge of approximately \$135,000 in debts. He directed company employees to divert approximately \$690,000 of his company income to several bogus companies, which he created in order to avoid paying creditors. The business owner failed to disclose his income

and control of the company to the bankruptcy court and SBA. The investigation also disclosed that he hid other assets from the bankruptcy court including several vehicles and a personal residence. This case was initiated based on a call from a former employee to the Denver SBA OIG office.

Pennsylvania Defunct Construction Company President Sentenced. One April 20, 2004, the president of a defunct construction company in Huntingdon Valley, Pennsylvania, was sentenced to 7 years in jail, 5 years probation, ordered to pay \$6,482,493 in restitution to the bonding company, a \$2,500 fine, and a \$1,300 special assessment fee. The president's bail was revoked and he was immediately remanded into custody. Previously, he was found guilty by a jury trial on December 19, 2003, for making **material false statements** to a federally insured financial institution and SBA, **mail and wire fraud, and money laundering** of \$495,000 from his construction business account to personal offshore accounts in the Bahamas to hide money from creditors. The president's illegal activities took place at a time that he was closing the construction business and abandoning its contracts and subcontractors. One of the false statement counts related to falsely representing, in his SBA Section 8(a) Annual Update Form and attachments, that he had relocated to Pennsylvania along with his SBA Section 8(a) certified business and that he controlled the day-to-day operations of the company. In furtherance of the fraud scheme, false financial statements were submitted to a bonding company. Ultimately the construction company defaulted on the contracts, resulting in a loss of almost \$6 million by the bonding company. The president also submitted false financial statements to a bank to support a \$300,000 construction company line of credit. This investigation was based upon a request from the NCIS. The SBA OIG conducted this investigation jointly with NCIS, the Veterans Administration OIG, and the DCIS.

This monthly update is produced by the SBA OIG,
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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 such documents please contact:

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