Office of Inspector General
Small Business Administration

January 2002 Update

Agency Management

Report on Most Serious Management Challenges Facing SBA Issued. OIG issued a report on the most serious management challenges facing the SBA in FY 2002. In it, OIG assessed Agency programs or activities that pose significant risks, including those that are particularly vulnerable to fraud, waste, error, or mismanagement. The report is based on specific OIG, General Accounting Office, or other reports, that are referenced in the individual sections, and our general knowledge of SBA programs.

The first four focus on Agency-wide issues that are critical to SBA's goal of modernizing the Agency. The other challenges are more specific to the Loan and Section 8(a) Business Development(BD) programs. This year we have further developed the "Actions Needed" sections and made them more specific in order to clarify the issues. In an attempt to reach a common understanding on what is needed to address the challenges, we developed them with substantial input from SBA officials. The Agency's comments helped us ensure all points of view were carefully considered and that the narrative discussions are accurate. The list of current challenges are below.

Acency-wide Issues
1) SBA needs to improve its managing for results processes and produce reliable performance data.
2) SBA faces significant challenges in modernizing its major loan monitoring and financial management systems.
3) Information systems security needs improvement.
4) Maximizing program performance requires that SBA fully develop and implement its human capital management strategies.

Loan Programs
5) SBA needs better controls over the business loan purchases process.
6) SBA needs to continue improving lender oversight.
Section 8(a)BD
7) More participating companies need access to business development and contracts in the Section 8(a)BD program.
8) SBA needs clearer standards to determine economic disadvantage.
9) SBA needs to clarify its rules intended to deter Section 8(a)BD participants from passing through procurement activity to non-Section 8(a)BD firms.
Fraud Deterrence and Detection
10) Preventing loan fraud requires additional measures, including new regulations and funding.

To view the full report, please visit our website at www.sba.gov/IG/toptenfy2002.pdf.

Business Loan Programs

Five New Jersey Defendants Charged in Two Indictments Plead Guilty. Five of the six defendants charged in two indictments by a New Jersey State grand jury have entered guilty pleas. Four individuals and two corporations had been charged with fraud against SBA and violations of environmental laws. In the first indictment, an East Rutherford, New Jersey, corporation and three of its principal officers were charged in connection with a $500,000 SBA-guaranteed loan obtained through a non-bank lender. The company was charged with **theft by failure to make required disposition** and four counts of **uttering a forged instrument**. Its chief financial officer (CFO), its president, and another of its principals were each charged with **theft by failure to make required disposition** and **misconduct by a corporate official**. The CFO and president were also indicted on four counts of **uttering a forged instrument**, while the other principal was indicted on three counts of **uttering a forged instrument**. The indictment alleged that the defendants failed to purchase machinery and fixtures as required in the loan agreement, provided a forged landlord waiver, and passed three forged checks to banks.

The investigation also resulted in a second indictment that focused on environmental crimes, naming the same four defendants plus a second company and its owner. The second indictment alleged that between September 1994 and November 1996, the defendants violated the Water Pollution Control Act by **discharging chemical wastes and industrial wastes** associated with the process of metal plating. The defendants were also charged with **unlawfully storing and abandoning toxic pollutants and hazardous wastes.** The second company was a successor of the first, having the same owner and business location.

On December 21, 2001, the CFO pled guilty to **theft by failure to make required disposition** and **abandoning toxic pollutants**; the president and other principal each pled guilty to **unlawfully storing hazardous wastes**. In addition, the second company pled guilty to **abandoning toxic pollutants and hazardous wastes** and its owner pled guilty to two counts of **unlawfully storing hazardous waste**. The charges against the first company were dropped after it became clear the company no longer existed. The State of New Jersey's Division of Criminal Justice conducted the investigation jointly with SBA/OIG and the U.S. Environmental Protection Agency (EPA) OIG.

Also, on December 21, 2001, the CFO, who was also the CFO of a now-defunct New York City electronic imaging company, pled guilty to **theft by failure to make required disposition**. The charge involved a scheme by him and other unnamed principals of the electronic imaging company to illegally divert funds from a December 1997 $1 million SBA-guaranteed loan from a non-bank lender for unauthorized purposes. This investigation grew out of the case against the first company.

<u>Ohio Pet Store President Sentenced to Prison</u>. The president of a pet store in Stow, Ohio, was sentenced on January 8, 2002, to 14 months imprisonment, 3 years supervised release, and $83,000 restitution. He was previously convicted on one count of **bank fraud** and one count of **making false statements to SBA** in connection with his $100,000 LowDoc loan. The jury found that he concealed both an outstanding $200,000 promissory note obtained from the previous pet store owner and substantial information regarding his criminal history during the application process. OIG initiated this investigation based on a referral from SBA's Cleveland District Office.

<u>Texas Automotive Service Center Owner Sentenced to Prison</u>. The owner of an auto service center in Irving, Texas, was sentenced on January 17, 2002, to 2 years incarceration followed by 3 years supervised release. Six months earlier, a jury had found her guilty on one count of **conspiracy** and five counts of **making material false statements** to induce a non-bank participating lender and SBA to fund a $156,000 SBA-guaranteed loan. She had submitted 3 years of falsified tax returns and Internal Revenue Service (IRS) tax return verifications, along with fraudulent documentation of the required capital injections and equipment purchases. Proceeds of the loan were used for personal expenditures not related to the business. OIG is conducting this ongoing investigation with the Department of Treasury's OIG for Tax Administration.

<u>OIG Vigilance Blocks $1 Million Loan to Texas Defendant</u>. The owner of a Grand Prairie, Texas, cleaners, allegedly engaged two individuals to submit an application for a $1 million SBA-guaranteed loan for the purported purchase of his business on January 14, 2002. The investigation found that his proposed sale of the business was a sham to obtain SBA-guaranteed funds. OIG notified the participating lender bank of the scheme and that the "seller" was under indictment for other alleged SBA-related loan frauds. The bank then declined the loan application the same day. He is to stand trial in March 2002, on 1 count of **conspiracy** and 25 counts of **making material false statements**. Some of the counts allege a scheme to induce a non-bank participating lender and SBA to fund a fraudulent $355,000 SBA-guaranteed loan for a gas station. He and others allegedly falsified nine Federal tax returns, six IRS tax verifications, two

leases containing forged signatures of the gas station company's regional and district managers, and an $85,000 capital injection. The indictment also charged the defendant and others in connection with an alleged fraudulent $200,000 SBA-guaranteed loan to another automotive repair and service station in Dallas, Texas. The defendants allegedly submitted six falsified copies of tax returns, three fraudulent IRS tax verifications, and numerous other fraudulent documents in support of the loan and a $60,000 capital injection into the business. In July 2000, OIG identified a scheme in which the defendant allegedly engaged two undocumented aliens to submit an application for a $1.2 million SBA-guaranteed loan for the sham purchase of the cleaners. Based on our notification, this loan application was also declined. This OIG accomplishment stems from the same investigation described in the preceding paragraph.

Former Illinois Company President Charged with Making Material False Statements. The former president of a contracting business in Aurora, Illinois, was charged in an information on January 24, 2002, with one count of **making material false statements** in connection with a $400,000 SBA-guaranteed loan. On February 6, 1997, a non-bank participating lender and SBA approved the loan that would provide working capital for the company. During the loan application process, the defendant signed an affidavit attesting that she and the company were both current on all Federal and State taxes. According to information gathered by SBA's Illinois District Office, when she signed this affidavit, she and the company had a tax debt totaling over $1 million. OIG initiated its joint case with the Federal Bureau of Investigations (FBI) based on a referral from SBA's Illinois District Office.

President of Pennsylvania Ship Repair Business and Guam Ship Building Company Honors Settlement. The president of a defunct Bensalem, Pennsylvania, ship repair business, and a shipbuilding business in Guam, honored a settlement agreement on October 23, 2001, by paying a participating lender bank almost $2 million. The ship repair business, an SBA-certified Section 8(a) firm, had a revolving line of credit loan agreement with the bank totaling approximately $7.5 million. This business also obtained a $650,000 SBA-guaranteed loan through the bank in 1997. It defaulted on both loans and filed for bankruptcy in 1999. The bank referred the matter to the U.S. Attorney's Office, Eastern District of Pennsylvania, for review. At the request of the U.S. Attorney's Office, SBA/OIG joined the resulting investigation being conducted by FBI, the Naval Criminal Investigative Service, the Defense Criminal Investigative Service, and the Pension and Welfare Benefits Administration. The investigation revealed that proceeds from the line of credit and the SBA-guaranteed loan were transferred to the ship building company without the knowledge and permission of the bank or SBA. At the settlement closing on October 23, 2001, releases were executed and the president then provided the bank with a $1,985,000 cashier's check. The bank applied $80,000 of these proceeds to reduce the SBA-guaranteed loan amount. Based on his settlement agreement with the bank and SBA, the U.S. Attorney's Office declined prosecution.

Disaster Loan Programs

New Mexico Woman Found Guilty of Money Laundering, Wire Fraud, Impersonation of Federal Employee, Filing False Claims, Making Material False Statements, and False Representation of Social Security Number. At the end of her trial on January 14, 2002, an Albuquerque, New Mexico, woman was found guilty on all 23 counts charged in her October 2001 indictment: 7 counts of **money laundering**, 5 counts of **wire fraud**, 6 counts of **mail fraud**, 2 counts of **impersonation of a Federal employee**, 1 count of **filing false claims**, 1 count of **making material false statements**, and 1 count of **false representation of a Social Security number** (SSN). The charges relate to her schemes attempting to obtain post-disaster assistance, including the application that resulted in her $40,000 SBA disaster home loan. The defendant, using the name and SSN of a deceased acquaintance, applied for disaster assistance from SBA and the Federal Emergency Management Agency (FEMA) under the Cerro Grande Fire Assistance Act. The defendant submitted numerous false documents in support of her damage claim; she also attempted to obtain information about her claim and investigation by posing as a representative of the U.S. Attorney's Office. The investigation determined that neither she nor her deceased acquaintance ever resided at the address claimed in the disaster assistance application. FEMA/OIG requested that SBA/OIG join its investigation.

Business Development Program

Former 8(a) Contractor President Sentenced. The president of a former Section 8(a) contractor was sentenced on January 11, 2002, to serve 6 months in home detention and 3 years on probation. He was also fined $2 million and ordered to pay $963,197 in outstanding fines relating to a 1993 **bribery** conviction. (The defendant paid the $2 million fine before his sentencing.) He previously pled guilty to one count of **obstruction of a Federal audit**. He admitted that, from 1993 to 1995, he had directed his staff to obstruct EPA auditors attempting to determine the appropriateness of the company's billings under EPA contracts. He and five associates had been indicted on charges of **racketeering, racketeering conspiracy, money laundering, bank fraud, mail fraud,** and **obstruction of a Federal audit**. A prosecution under the Racketeer Influenced and Corrupt Organizations Act involves allegations that a group of persons formed an "enterprise" which then engaged in a series of corrupt or illegal activities. In this case, he initially entered SBA's Section 8(a) program in Ohio in 1980, as primary owner of the company, a hazardous-waste cleanup contractor. The indictment alleged that in the late 1980s, shortly after the company was "graduated" from the program, he obtained (in the name of his son and codefendant to conceal his role) Section 8(a) status in Kentucky, and later in California, for another company he controlled. The indictment further alleged that another waste cleanup company purportedly headed by the defendant's other son and codefendant fraudulently obtained Section 8(a) status in Kentucky. As of the date of the indictment, these Section 8(a) companies had been awarded Federal contracts totaling more than $150 million. Pursuant to the defendant's plea agreement, at his sentencing the Government dismissed all the other charges of the indictment against him and his codefendants. The OIGs of EPA, Department of Defense, and SBA conducted the investigation.

Missouri Section 8(a) Company and President Plead Guilty to Mail Fraud. A Poplar Bluff, Missouri, Section 8(a) company and its president pled guilty on January 22, 2002, to three counts each of **mail fraud**. They were previously charged in a 12-count felony indictment that also included counts of **major fraud against the United States**, **obtaining illegal kickbacks**, and **making material false statements**. In the plea agreement, the president admitted to devising a scheme to fraudulently obtain money from insurance companies that insured the company's property and equipment. As part of the plea, the president and his company agreed to make restitution totaling $13,101 to two insurance companies and to repay $669 that he wrongfully withheld from two of his employees. The defendant also agreed to pay fines totaling $250,000. In exchange for the Government's promise to dismiss the remaining counts of the indictment, the defendant and the company further agreed to voluntarily withdraw and forever be barred from participation in SBA's Section 8(a) and other programs, including all SBA certifications, assistance, and resources. The company also agreed to surrender all surplus property obtained as a result of their certification in the Section 8(a) program. The company and its president remain suspended from all Federal contracting, with debarment proceedings pending against them. Sentencing of the defendants has been set for March 11, 2002. SBA/OIG investigated this case jointly with FBI and the Department of Labor's OIG.

Office of Inspector General

OIG Responds to Congressional Request to Analyze SBA's Efforts to Identify and Reduce Level of Erroneous Payments. OIG responded to a request from the Senate Committee on Governmental Affairs requesting its assessment of SBA's efforts to identify and reduce the level of erroneous payments. OIG's response evaluated SBA's answer to the Committee as to the level of erroneous payments and actions taken by the Agency to reduce these payments. In its response, the Agency acknowledged that it does not have estimates of the amount of improper payments made in the last 2 years in the Section 7(a) Business Loan, Section 504 Certified Development Company, Small Business Investment Company, and Disaster Assistance Programs. OIG concurred with this assessment and committed to work with the Agency to develop processes to identify such estimates.

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 on our publications, suggestions for possible audits, or referrals of possible incidents of waste, fraud, or abuse.

The activity Update is produced by SBA/OIG,
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Comments or questions concerning this Update or request for copies of OIG audits, inspections, and/or other documents should be directed to:

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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**
or

TOLL-FREE FRAUD LINE (800) 767-0385