



Office of Inspector General U.S. Small Business Administration

January 2007 Update

Business Loan Programs

Multiple Arrest Warrants Served. On January 9, 2007, the SBA OIG and the U.S. Secret Service began serving arrest warrants on 19 individuals, 5 of whom had been previously indicted. By January 11, 2007, 18 of the 19 individuals had been arrested, appeared before a U.S. Magistrate, and were released on bond. The last individual was reportedly out of the country. Those charged by indictment were as follows:

- Indictment #1 – A former executive vice president of a Small Business Lending Company (SBLC) in Troy, Michigan, was charged in a 14-count indictment with conspiracy, wire fraud, tampering with witnesses, making false declarations to a Grand Jury, and making false statements to a federally-insured bank. The indictment described a scheme whereby the former vice president and others conspired to fraudulently qualify loan applicants for SBA-guaranteed loans, primarily for the purchase of gas stations. The indictment alleged that the former vice president fraudulently caused the SBLC to make as many as 76 SBA-guaranteed loans totaling approximately \$76,869,200, and that SBA had already paid claims totaling approximately \$28,423,223 on these loans.
- Indictment #2 – Three individuals were charged with conspiracy and making false statements. According to their indictment, the first two individuals fraudulently obtained from the SBLC a \$944,000 SBA-guaranteed loan to a Clio, Michigan, gas station, and the third individual facilitated the fraud by providing phony bank documentation to verify the required equity injection. The indictment stated that SBA had paid a claim of \$709,264 on this defaulted loan.

- Indictment #3 – A former assistant vice president of a Dearborn, Michigan, bank was charged with conspiracy and misapplication of bank funds as a result of her alleged involvement in the conspiracy. According to the indictment, she participated in a scheme to defraud SBA by supplying false verifications of deposits for loan applicants and by giving the loan broker unpaid-for cashier's checks to be used in connection with the loan closings.

This case was initiated based on information received from the U.S. Attorney's Office, Detroit, Michigan. The OIG conducted this joint investigation with the U.S. Secret Service.

504 Loan Debenture Cancelled. On January 3, 2007, the SBA cancelled a 504 loan debenture in the amount of \$1,153,000 that SBA had approved on December 16, 2006, for the purchase of a Houston, Texas, gas station. Our investigation revealed that false documents had been submitted misrepresenting the source of the borrower's equity contribution. The OIG conducted this joint investigation with the Texas Alcoholic Beverage Commission.

Reports on Audits of SBA-Guaranteed Loans. As part of an ongoing review of SBA's guaranty purchase process, the OIG randomly selected purchased loans to assess the guaranty purchase process and project the overall level of erroneous payments. In order to recover identified erroneous payments relating to individual loans, the OIG issues separate reports for each lender. Two such reports were issued during January 2007.

- On January 16, 2007, the OIG issued a report on an SBA-guaranteed loan that identified a lender who requested a guaranty purchase from SBA without complying with SBA requirements in determining the value of the business being purchased. Furthermore, the lender allowed a

change of ownership to occur that was not an arm's-length transaction, and did not properly calculate the borrower's repayment ability. As a result, SBA erroneously paid the lender \$183,297 on the loan guaranty. OIG recommended that SBA seek recovery of \$183,297 from the lender. The lender agreed with the finding and SBA agreed to recover the funds.

- On January 9, 2007, the OIG issued a report on an SBA-guaranteed loan to a legal assistance company that found the lender did not verify \$66,150 of the required \$117,000 of equity injection. In addition, the lender's cash flow analysis was not supported and contained unexplained anomalies, making the borrower's repayment ability questionable. Furthermore, the lender did not inventory and assess the collateral in accordance with SBA policy. As a result, the loss to SBA was increased on this loan. The OIG recommended that SBA seek recovery of \$141,689 from the lender. SBA agreed with the findings and recommendation. The lender did not provide a written response to the audit, but submitted a check to SBA for the full recommended recovery amount.

Texas Business Owner Pleads Guilty. On January 12, 2006, the owner of a Houston, Texas, trading company pled guilty to one count of conspiracy to commit bank fraud in connection with a fraudulent scheme to secure a \$2.4 million SBA-guaranteed loan. The business owner, who had been previously indicted along with seven other co-conspirators, admitted that he and a business associate conspired with a loan broker and others to submit a false loan application to an SBA lender to finance the purchase of a warehouse. They misrepresented the purchase price of the warehouse to be \$2.2 million, when the actual price was approximately \$1.5 million, and falsified part of the required equity injection. Two of the other individuals who were indicted fled the country and remain fugitives.

Former Company Officer Sentenced. The former secretary of a now-defunct seafood wholesaler in Newark, New Jersey, was sentenced to 3 years probation and restitution in the amount of \$143,618, of which \$129,256 is to be paid to SBA and the remainder to a lender. The sentencing resulted from his guilty plea on October 12, 2006, to one count of misprision of a felony for assisting the company in

obtaining an SBA-guaranteed line of credit. He obtained the letter of credit to enable the company to purchase seafood in America for export to Asia, and the terms of the financing required the purchase of American products, if possible. He submitted five fraudulent invoices to the lender, purportedly from two American suppliers, inducing the lender to lend the company \$219,504 from the line of credit. The company paid back approximately \$75,885 and defaulted on the remaining balance of \$143,619. This case was originally referred to the OIG by SBA's New Jersey District Office.

New Jersey Business Owner Charged. On January 31, 2007, the owner of an accounting business located in Montclair, New Jersey, was charged in a criminal information with one count of money laundering and one count of aiding and abetting involving a scheme to defraud SBA. He prepared a fraudulent tax record for a Philadelphia-based supermarket company to make it appear that the company's financial condition was stronger than it actually was and, thereby, increase the likelihood that an SBA-guaranteed loan would be approved. The company ultimately obtained an SBA-guaranteed loan in the amount of \$993,000. The owner of the supermarket company previously pled guilty to one count of wire fraud and aiding and abetting involving this SBA-guaranteed loan. The OIG conducted this joint investigation with the Federal Bureau of Investigation.

Former Washington State Business Owner Sentenced. On January 23, 2007, the former owner of a cabinet making business in Everett, Washington, was sentenced to 12 months and one day in prison and 5 years supervised release, and was ordered to pay restitution of \$886,506. He was charged on September 15, 2006, via a criminal information, with one count of false statements to SBA and one count of false statements to a bank. He pled guilty to both charges. The investigation found that he inflated his Personal Financial Statement and failed to disclose a prior bankruptcy when applying for a \$1.5 million SBA-guaranteed loan to purchase the cabinet making business. He also submitted the same false financial statement to a federally-insured financial institution to obtain a \$400,000 line of credit for the business. This case was originally referred to the OIG by a lender.

Former Company President Pleads Guilty. On January 17, 2007, the former president of a Virginia Beach, Virginia, business pled guilty to one count of mail

fraud, one count of tax evasion, and one count of engaging in a monetary transaction in criminally derived property. The business was an internet-based company that promised to provide a comprehensive business plan and an SBA-guaranteed loan in exchange for \$3,500. The company lauded a 90 percent success rate in obtaining SBA-guaranteed loans for its customers. It also advertised that it was a member in good standing with the Ethical Internet Buyers Bureau (EIBB). Our investigation disclosed that the business plans were worthless, that only one or two businesses ever received an SBA-guaranteed loan, and that the founders and operators of the EIBB were, in fact, co-conspirators. At least 600 people were victimized by the scam. This case was based on a referral from SBA's Richmond District Office. The OIG conducted this joint investigation with the U.S. Postal Inspection Service and the Internal Revenue Service.

Corporate Officers Sentenced. On January 4, 2007, three corporate officers of a landscaping company were sentenced in Federal District Court in Salt Lake City, Utah, to 12 months of home confinement and supervised release, and ordered to pay total restitution of \$326,144.35. All three officers had previously pled guilty. Our investigation determined that the officers of the landscaping company submitted false loan documentation to two different financial institutions in order to obtain separate SBA-guaranteed loans totaling \$470,100. They failed to disclose that they had between \$160,000 and \$190,000 in delinquent payroll taxes. This case was initiated based on a referral from a lender.

International Trade

Report on Efforts to Assist Small Businesses Compete in International Markets. On January 29, 2007, the OIG issued a report, *Efforts to Assist Small Businesses Compete in International Markets*, that presented the results of a survey of SBA's trade facilitation activities. The survey, conducted in response to a request from three members of Congress, found that SBA had, in the general course of its work, identified key international trade constraints confronting small businesses seeking markets abroad for their products and services, but had not attempted to formally survey small businesses. SBA had looked to the Department of Commerce as the Federal government's lead agency in disseminating trade promotion information, developing business leads, and facilitating business

matchmaking for all sizes of U.S. businesses. Consequently, SBA had focused its modest resources on assisting small businesses mostly with export finance assistance. Finally, although SBA is a member of the Trade Committee, it has played only a minor role, has had a minimal share of the total budget authority as compared with other members of the committee, and did not have its annual accomplishments and upcoming trade plans sufficiently described in the Trade Committee's most recent annual strategic document, *The 2006 National Export Strategy*.

Agency Management

Audit of SBA's FY 2006 Financial Statements – Management Letter. KPMG LLP's Management Letter, which identified 12 conditions that came to the Independent Auditor's attention during its audit of SBA's FY 2006 financial statements, was issued on January 17, 2007. The financial statement audit was performed by KPMG under a contract with the OIG. KPMG found that improvements were needed in: (1) reconciliation of the monthly Fund Balance with Treasury; (2) field cashiering; (3) review of data used in the credit reestimate models; (4) controls over cash and negotiable instruments at the Little Rock Commercial Loan Servicing Center (CLSC); (5) controls over the checks on hand at the Disaster Loan Processing Center; (6) the guaranteed loan charge-off process; (7) the guaranteed loan purchase process; (8) the Disaster loan charge-off process; (9) the Disaster loan modification process; (10) the Disaster loan disbursement process; (11) the management and tracking of loan files; and (12) controls over official personnel files. KPMG made 28 recommendations to SBA's Chief Financial Officer, Associate Administrator for Disaster Assistance, Chief Human Capital Officer, and Associate Deputy Administrator for Capital Access. These officials generally concurred with most of the findings. They agreed to implement all of the recommendations, or have already taken actions to address the identified conditions.

Statutory/Regulatory/Policy Reviews

In an effort to proactively identify and correct potential Agency inefficiency and management problems at the onset of policy and regulatory development, the OIG reviewed, cleared, and/or

provided comments, as appropriate, on 13 Agency initiatives, including proposed legislation, SBA Standard Operating Procedures, and Agency notices containing directives to its employees.

This monthly update is produced by the SBA OIG, Eric M. Thorson, 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:

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