



Office of Inspector General U.S. Small Business Administration

June 2006 Update

Disaster Loan Program

OIG Issues Advisory Memorandum Report on Disaster Credit Management System (DCMS). On June 8, 2006, the OIG issued an *Advisory Memorandum Report – Review of the Disaster Credit Management System Performance Test Plan*. The purpose of this report was to inform SBA of the disparity between system requirements presented to and approved by SBA's Business Technology Investment Council (BTIC) and the performance test success criteria in the DCMS Upgrade Performance Test Plan. The report identified a potential risk that the implemented DCMS Upgrade will not meet the system requirements approved by the BTIC for the support of 10,000 concurrent users. We made two recommendations to correct the deficiencies identified in the report. The Agency partially agreed with the first recommendation. The second recommendation was added in response to comments received from SBA.

Texas Man Indicted. On June 28, 2006, a Federal grand jury indicted a Texas man for wire fraud, mail fraud, and identity theft. He had filed multiple applications for Federal Emergency Management Agency (FEMA) benefits as a result of Hurricanes Katrina and Rita, fraudulently claiming to have resided at multiple locations in the disaster areas when the hurricanes struck. In reality, he was residing in the Houston, Texas area at the time of the hurricanes. As a result of these false claims, he received approximately \$35,000 in cash benefits. These false claims also caused the man to be eligible for SBA disaster loan benefits. He filed a fraudulent disaster loan application with SBA, but was declined. The indictment resulted from a joint pro-active investigation involving the Department of Justice Hurricane Katrina Fraud Task Force. The task force includes the United States Attorney's Office, SBA

OIG, Department of Homeland Security OIG, Social Security Administration OIG, U.S. Postal Inspection Service, Department of Labor OIG, and Department of Housing and Urban Development OIG, and targets individuals making false claims for various hurricane-related government benefits.

Former Attorney Debarred. On June 29, 2006, SBA debarred a former Mamaroneck, New York, attorney from participating in Federal financial and non-financial programs for three years. This action resulted from an OIG recommendation that the former attorney be debarred for defrauding the government to obtain an Economic Injury Disaster Loan after the September 11, 2001 terrorist attacks. He obtained a \$247,000 SBA loan after claiming that his law firm lost revenue because its office was located near the World Trade Center and could not operate after the terrorist attacks. The OIG's investigation determined that the law firm never had an office located near the World Trade Center. The man previously pled guilty to one count of wire fraud and one count of money laundering, and received 18 months imprisonment, three years supervised release, and was ordered to pay restitution of \$18,500.

Business Loan Programs

Loan Canceled. On June 7, 2006, a bank canceled an SBAExpress loan of \$100,000 to an auto repair shop located in Wayne, Pennsylvania as a result of information provided by the OIG. We were advised by a complainant that the company may have provided false information in conjunction with the loan application. Our subsequent investigation disclosed that the application package did, in fact, contain incorrect information for the individual who was listed as 100 percent owner of the company. The investigation further determined that this individual had not had any direct contact with bank employees in connection with the loan application process because an unknown person had

obtained the loan application from the bank and returned the completed forms. Information obtained by the OIG was provided to the bank which then canceled the loan, resulting in a cost avoidance of \$100,000.

OIG Issues Fraud Alert. As a result of ongoing OIG work, we proactively initiated an information notice alerting SBA employees and lenders about fraudulent schemes affecting the SBAExpress loan program. In one case that was referred by a bank, we are investigating a loan packager scheme involving 57 loans of smaller dollar value (generally under \$50,000) in which the business applicants either did not exist or presented false business histories. The bank became aware of the fraud, thus ensuring that not all of these loans were made. Similar schemes are being perpetrated against other lenders. The OIG is working with lenders to investigate these schemes and will seek criminal prosecution where appropriate. The information notice describes some of the patterns and indicators of potential fraud.

Six People Indicted. On June 13, 2006, three indictments were filed in the Eastern District of Michigan charging six individuals for their roles in alleged schemes to defraud the SBA and a participating lender. The indictments allege that the individuals were involved in a conspiracy to provide false information when applying for SBA-guaranteed loans to purchase gas stations/convenience stores. SBA OIG conducted this joint investigation with the Department of Homeland Security.

Indictment 1 – A part owner of a gas station and convenience store in Warren, Michigan, his wife, and a loan broker were indicted on charges of conspiracy and false statements in order to obtain a \$1,350,000 SBA-guaranteed loan. The indictment alleges that the owner and loan broker claimed that the part owner made an equity injection of at least \$240,000 prior to the disbursement of the loan. The indictment also charges that his wife, a credit union employee, falsely reported that the company had an account balance of over \$63,000 at the credit union. The loan defaulted and SBA paid a claim of \$1,039,260 in June 2003. Arrest warrants have been issued, and all three defendants are fugitives. It is believed that the part owner and his wife have fled to Australia, and the loan broker has returned to his native Qatar.

Indictment 2 – A part owner of a gas station and convenience store in Auburn Hills, Michigan, his undisclosed partner, and the seller of the property, were indicted on charges of conspiracy, false statements, and wire fraud in connection with a \$1,165,000 SBA-guaranteed loan used to purchase the property. The indictment alleges that the three individuals were involved in a conspiracy that falsely claimed that the part owner was a U.S. citizen, a former gas station manager, and the sole owner of the business. In addition, it is alleged that two checks were altered to make it appear that he had made a \$250,000 down payment toward the purchase of the property. He defaulted on his SBA-guaranteed loan and SBA paid a claim of \$1,019,943 in November 2002.

Indictment 3 – The president of a company and his brother, who was the president of a second company, were charged with false statements, conspiracy, and aiding and abetting in connection with a \$990,000 SBA-guaranteed loan made to the first company. The approved purpose of the loan was to assist in the purchase of a gasoline station and convenience store located in Detroit, Michigan. However, our investigation determined the actual object of the alleged scheme was to merely refinance and consolidate delinquent debts owed by the financially-troubled seller using proceeds from the loan made to the “straw buyer.” The loan defaulted and SBA purchased its guaranty for \$719,106.84 in November 2003.

Cash Settlements Reached. Pursuant to a civil complaint filed against seven individuals in Illinois, a Chicago area businessman and two former Chicago-area real estate attorneys entered into individual cash settlement agreements for their involvement in a conspiracy and fraud scheme committed against the SBA and a participating lender. The businessman settled the government’s claims against him in exchange for a cash payment in the amount of \$100,000, and the two former attorneys settled the claims against them in exchange for cash payments of \$10,000 and \$25,000, respectively. Previously, another Chicago-area businessman entered into a \$100,000 cash settlement agreement for his involvement in the scheme. That individual was also found guilty of conspiracy to obstruct justice in a separate scheme to produce fabricated documents to the SBA OIG in response to grand jury subpoenas. This investigation involved a \$1.25 million SBA loan for the purchase of a restaurant. The parties to the transaction conspired to provide an unqualified borrower (an illegal

alien and convicted felon) with the funds required for his capital injection. The scheme essentially provided the borrower with 100 percent financing and resulted in a fraudulent inflation of the sales price, thereby exposing the government to additional loss and reduced recovery potential.

Puerto Rico Businessman Sentenced. A businessman in Puerto Rico was sentenced on May 23, 2006, to three years probation, \$43,590.81 in restitution, and a \$100 assessment fee. He previously pled guilty to one count of conspiracy. After the businessman had been denied an SBA Micro-loan because of his poor credit history, he conspired with his brother and another man to apply for and receive a \$25,000 SBA Micro-loan on his behalf. The brother and the third individual falsely claimed on their loan applications that the proceeds of the loan would be used to purchase inventory for their respective businesses. The proceeds were actually for the use and benefit of the first individual. All three individuals were indicted on September 22, 2004. Judicial proceedings are continuing against the brother. The third individual previously pled guilty and has been sentenced. This investigation was based on a referral from a Micro-loan lender in Puerto Rico. The OIG conducted this joint investigation with the Federal Bureau of Investigation (FBI).

Government Contracting and Business Development

Debarment Action. The U.S. Army recently debarred the former president of a Portsmouth, Virginia, environmental services company from government contracting until February 23, 2009. This action was based upon his guilty plea in June 2005 to one count of conspiracy to defraud SBA and the Environmental Protection Agency (EPA). The company was an SBA 8(a) certified firm in which the former president qualified as the disadvantaged individual. He and a former vice president of the company conspired to make misrepresentations to SBA so that the company could maintain its 8(a) eligibility. They further conspired to provide false hazardous environmental training certificates on contracts, which violated EPA regulations. The former president was sentenced in January 2006 to five months in prison, five months home detention, three years supervised release, a \$1,000,000 fine, and a \$100 special assessment. The OIG conducted this joint investigation with the FBI,

Defense Criminal Investigative Service, EPA Criminal Investigation Division, Army Criminal Investigation Division, National Aeronautics and Space Administration OIG, Defense Contract Audit Office, and the Virginia Department of Professional and Occupational Regulation.

Agency Management

OIG Issues Report on Implementation of Improper Payments Information Act. On June 21, 2006, the OIG issued a report, *Audit of SBA's Implementation of the Improper Payments Information Act*. The purpose of this report was to determine whether SBA developed an erroneous payment identification, reporting, and reduction program that was in compliance with the Act, and whether management could rely on the existing erroneous payment activities to provide several of the basic components of an effective internal control program required by OMB Circular A-123. We found that the Agency had not established uniform Agency-wide processes and procedures for the full range of erroneous payment risk assessment and reporting activities. We made three recommendations to improve compliance with the Act. The Agency generally agreed with the recommendations, requesting minor modifications based on current SBA risk assessment guidelines and pending guidance changes in A-123.

Agency Completes Final Action on Three Recommendations Made in Audit of SBA's FY 2005 Financial Statements—Management Letter (Report 6-10). The Agency reported that it completed the following final actions. The Agency provided training on the administration of accountable property to Administrative Officers to ensure the Agency's policies are properly followed. Additionally, it completed a review of certain procedures (namely the controls over the availability of supporting documentation for all transactions recorded in the general ledger, and the controls over shipping and tracking of loan files) and has determined that they were adequate to achieve the intended operational and financial reporting objectives. Sixteen recommendations contained in the audit report remain open.

Agency Completes Final Action on Recommendation Made in the Audit of SBA's Implementation of the Joint Accounting & Administrative Management System (JAAMS) (Report 3-32). The Agency reported that it completed the following final action. The Agency

completed an analysis of the number of Oracle software applications procured for JAAMS versus the number of applications actually required. The Agency determined that ten applications were not needed and that it would discontinue paying the license fees for these ten applications. The Agency negotiated a discount from Oracle to compensate for the software purchased but not used. One recommendation contained in the audit report remains open.

Agency Completes Final Action on Recommendation Made in Audit of SBA's FY 2005 Financial Statements (Report 6-04). The Agency reported that it completed the following final action. The Office of Chief Financial Officer (OCFO) implemented a change control process which requires documentation, review, and approval for all changes made to proforma entries recorded in the Financial Reporting Information System (FRIS). The process also includes the participation of an OCFO Change Control Board, and the procedures for both accounting and systems change controls are being updated. Eight recommendations contained in the audit report remain open.

Agency Completes Final Action on Recommendation Made in the Audit of SBA's Information System Controls for FY 2004 (Report 5-12). The Agency reported that it completed the following final action. The Office of the Chief Information Officer (OCIO) provided documentation of training in software development, testing, and acceptable procedures for its contractor personnel. Additionally, all Loan Accounting System software must be documented in accordance with SBA policy and standards. Fifteen recommendations contained in the audit report remain open.

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 15 Agency initiatives, including proposed legislation, Agency Standard Operating Procedures, and Agency notices containing directives to its employees.

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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 these documents please contact:

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