



Office of Inspector General U.S. Small Business Administration

March 2007 Update

Business Loan Programs

Audit of the Office of Lender Oversight Corrective Actions Process. On March 15, 2007, the OIG issued a report, *Audit of the Office of Lender Oversight Corrective Actions Process*. The objective of the audit was to determine whether SBA's Office of Lender Oversight (OLO) had fully implemented a corrective action process and ensured that identified lender deficiencies were addressed timely. We determined that OLO had strengthened its oversight process by (1) expanding the scope of lenders reviewed, (2) providing more detailed reports to lenders, and (3) requiring corrective actions when deficiencies were identified. However, we found that the oversight process had not been fully implemented. Of the 350 lenders eligible for on-site reviews, only 125 were reviewed during Fiscal Years (FY) 2005 and 2006. In addition, OLO had not transmitted on-site review results to lenders 6 to 12 months after the end of the reviews. Lastly, deficiencies noted during on-site reviews for 113 loans either were not recorded in the Delinquent Loan Collection System or were not recorded timely, which may have resulted in SBA inappropriately honoring guaranties totaling \$734,676 for 8 loans.

The audit report contained two recommendations addressed to the Director of OLO, and one addressed to the Acting Director, Office of Financial Assistance (OFA). The Director of OLO responded that actions had been taken or were in process to address the first two recommendations. The Acting Director of OFA stated that her office would evaluate the identified deficiencies applicable to the 8 loans and determine whether any recoveries were warranted.

Lender Repays/Terminates Loan Guaranties. In January, agents from the SBA OIG and the U.S. Secret Service arrested 18 individuals sought in connection with a scheme in which a non-bank lender's former

executive vice president and others conspired to fraudulently qualify loan applicants for SBA-guaranteed loans. An indictment against the former executive vice president alleged that this scheme caused the lender to originate as many as 76 fraudulent loans, totaling almost \$77 million, and that SBA had already paid claims totaling approximately \$28.4 million on these loans. As a result of this investigation, the lender repurchased guaranties from SBA on three fraudulent loans, resulting in administrative recoveries of over \$1.8 million, and terminated its guaranties on two other fraudulent loans that SBA had not yet purchased, resulting in cost savings of over \$1.4 million. Following the arrests, the lender also repaid SBA over \$9.6 million for 19 fraudulent loans identified in the investigation. Consequently, SBA recoveries and cost savings to date total over \$12.8 million.

Defendant Sentenced for Role in Fraudulent Scheme. On March 13, 2007, a Houston, Texas, man was sentenced to 18 months in a Federal correctional facility, followed by three years of supervised release, and ordered to pay \$624,564.76 in restitution jointly with four other defendants. He had previously pled guilty to one count of bank fraud in connection with a scheme to secure a \$1 million SBA-guaranteed loan from a lender. The scheme involved submission of a purchase contract which showed an inflated sales price of \$1,320,000 for a convenience store, when the true purchase price was only \$788,617. The lender disbursed loan proceeds of \$1 million relying on these and other misrepresentations. The OIG conducted this investigation with assistance from the Texas Alcoholic Beverage Commission.

Business Owner Pleads Guilty. On March 7, 2007, a Chicago area business owner pled guilty to one count of bribery of a public official in connection with his application for a \$594,000 loan through SBA's Section 504 loan program. The business owner had submitted a loan application to make improvements and buy a

new property for his company, an interstate trucking firm, which claimed that he was a U.S. citizen. However, when SBA requested evidence of naturalization, he admitted that he was not a U.S. citizen, but requested a meeting with an SBA official. At this meeting, which was staged by OIG agents, he again admitted he was not a U.S. citizen, but presented a counterfeit certificate of naturalization for the SBA loan file and offered a \$5,000 cash bribe to the SBA official. The OIG's investigation revealed that he had hired the owner of a graphic arts company to create the counterfeit certificate of naturalization. The graphic artist was previously convicted of possession of fictitious or fraudulent identification cards. This ongoing investigation is being conducted jointly with the Department of Homeland Security (DHS). In addition, SBA's Illinois District Office provided significant cooperation in this investigation.

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.

On March 9, 2007, the OIG issued an audit report on an SBA-guaranteed loan which found that the lender did not originate and service the loan in accordance with SBA's policies. One of the borrowers did not pay payroll taxes timely, which should have been considered a character issue during loan origination. Furthermore, the lender did not identify that one of the borrowing businesses had two 50 percent shareholders and, as a result, did not obtain a guarantee or a Statement of Personal History from the second shareholder, as required. The lender also inappropriately disbursed \$7,500 for a broker fee charged to the borrower. Lastly, the lender calculated the default date incorrectly and accrued \$111,237 of excess interest. Due to the materiality of the deficiencies identified on this loan, we recommended recovery of the \$77,683 guaranty paid.

The lender agreed that the borrower's character was questionable and that the loan was not properly guaranteed, and agreed to pay the recommended recovery amount. However, the lender did not agree that loan payments were inappropriately applied to interest and that the loan default date was

miscalculated. SBA concurred with the recommendation to seek recovery of \$77,683, but also questioned our finding regarding the borrower's application of payments to interest after default. While we included this finding in our final report, we acknowledged that this was a grey area and that SBA's policies and procedures did not clearly specify how borrower payments received after default should be applied. Consequently, this issue may be the subject of a future audit.

Disaster Loan Program

Three Individuals Indicted/Sentenced for Filing False Disaster Claims. Three individuals were indicted or sentenced for falsely claiming disaster benefits related to Hurricane Katrina.

- On March 6, 2007, a man was indicted in U.S. District Court for the Southern District of Mississippi on one count of false, fictitious, or fraudulent claims, one count of theft of public funds, two counts of false statements, three counts of wire fraud, one count of false statements on a loan application, and one count of civil forfeiture. He had claimed that his primary residence was in Biloxi, Mississippi, at the time of Hurricane Katrina. However, based on a joint investigation by the SBA OIG, DHS OIG, and the Mississippi State Auditor's Office, it was determined that he actually resided in Maryland at the time of the hurricane. He was approved for an SBA loan of \$208,300, of which an initial \$10,000 was disbursed. He also received \$15,818 from the Federal Emergency Management Agency (FEMA).
- Also On March 6, 2007, a second man was indicted in U.S. District Court for the Southern District of Mississippi on one count of false, fictitious, or fraudulent claims, five counts of false statements, two counts of theft of public funds, and three counts of wire fraud. This indictment resulted from a joint investigation involving the SBA OIG, DHS OIG, U.S. Department of Agriculture (USDA), and the Mississippi State Auditor's Office. The individual had provided a false address on applications for benefits from all three Federal agencies. While his primary residence was not affected by Hurricane Katrina, his secondary residence was damaged. However,

he claimed his secondary residence as his primary residence in an attempt to fraudulently obtain disaster assistance funds. Based on these false statements, he was approved for a \$78,900 loan from SBA, of which an initial \$10,000 was disbursed. In addition, he received \$9,558 from FEMA and \$301 from USDA.

- On March 8, 2007, a woman was sentenced in the Eastern District of Louisiana to 60 months probation and ordered to pay \$10,000 in restitution to SBA. She had previously entered a plea of guilty to a criminal information charging her with one-count of false statements. She had filed applications for SBA and FEMA disaster benefits claiming to have lived in an area affected by Hurricane Katrina when, in fact, she resided with her parents at the time of the hurricane and did not suffer any damages. Based on this false claim, she was approved for a \$40,000 SBA disaster loan and received an initial disbursement of \$10,000. The OIG notified SBA's Disaster Processing and Disbursement Center in Ft. Worth, Texas, to stop disbursement of the remaining \$30,000. The woman also received FEMA assistance as a result of this false claim. This investigation was conducted jointly with the DHS OIG.

Government Contracting & Business Development

Audit of 8(a) Sole-Source Contracts. On March 30, 2007, the OIG issued a report, *Audit of Two 8(a) Sole-Source Contracts Awarded to Contractors in SBA's Mentor Protégé Program.* We reviewed two 8(a) sole-source dredging contracts awarded by the Army Corps of Engineers to contractors participating in SBA's Mentor Protégé Program. The audit was initiated in response to a complaint which alleged that the contracts were performed by large businesses in violation of small business procurement laws and regulations and contrary to the intent of the 8(a) and Mentor Protégé programs. The audit substantiated the complainant's allegations, finding that large businesses performed 86 to 98 percent of the dredging work and materially benefited from the contracts that were sole-sourced to 8(a) participants.

We found that SBA accepted both contracts into the 8(a) program even though neither contractor met 8(a) size standards. In addition, one contract failed to

demonstrate how the 8(a) contractor would benefit from the joint venture, and the other contractor did not meet other 8(a) program eligibility requirements. From discussions with responsible Agency officials, the Army Corps of Engineers, and the contractors, it was determined that SBA did not detect these deficiencies because the Agency: (1) accepted procurements prior to contract solicitation, leaving it without the information needed to determine whether applicants met the size standards; (2) did not have a sufficient number of trained individuals to effectively perform its oversight responsibilities under the 8(a) program; (3) had not developed sufficient 8(a) program monitoring procedures and properly communicated program requirements; and (4) did not hold procuring agencies accountable for their compliance with 8(a) program monitoring requirements.

Previous work completed by the OIG and the Government Accountability Office (GAO) also identified systemic internal control weaknesses in SBA's oversight that continue to affect the integrity of the 8(a) and Mentor Protégé programs. SBA must strengthen internal controls over the 8(a) and Mentor Protégé programs to ensure that these programs operate as statutorily mandated, with minimal potential for fraud, waste and abuse.

The Agency generally agreed with the OIG's findings and recommendations.

Agency Management

Information Technology Security Assessment. On March 6, 2007, the OIG issued the results of the independent auditor's Information Technology Security Assessment, which identified entity-wide security vulnerabilities that were identified during its audit of SBA's FY 2006 financial statements. The review identified a number of external and internal vulnerabilities in SBA's network and outlined five recommendations to correct the deficiencies identified. The Chief Information Officer agreed with all five recommendations.

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 11 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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