



Office of Inspector General U.S. Small Business Administration

May 2006 Update

Disaster Loan Program

Former New York Business Owners Plead Guilty/Sentenced. A former co-owner of a New York, NY, wealth management company pled guilty on May 19, 2006, to one count of conspiracy to commit false statements, one count of making false statements, and five counts of mail fraud. A second co-owner, who previously pled guilty to one count of conspiracy, two counts of making false statements, and one count of mail fraud, was sentenced in the Southern District of New York on May 3, 2006, to serve 24 months in prison, pay \$2,500 restitution to a New York Charitable organization, and pay a \$400 special assessment fee. Both individuals were previously indicted for falsely claiming physical damage and economic injury as a result of the September 11, 2001, terrorist attacks in New York City. They applied for an SBA disaster loan for their company in the amount of \$1,000,000, falsely stating on the application that the company was located in the immediate vicinity of the World Trade Center and suffered physical damage and economic injury as a result of the terrorist attacks. Their loan request was denied by the SBA because the first co-owner had never filed Federal tax returns. The second co-owner also fraudulently applied for and received \$2,500 in aid from a charitable organization in New York City. Both individuals were extradited from Japan in October 2005, and have been incarcerated in New York City since. This investigation was originally referred to the OIG by SBA's Niagara Disaster Office. The SBA OIG is conducting this joint investigation with the Social Security Administration, OIG.

South Carolina Man Pleads Guilty. The owner of a Darlington, South Carolina, manufactured home sales dealership pled guilty on May 5, 2006, to one count of bank fraud and one count of mail fraud. The man obtained a disaster loan for \$487,600 for economic

injury as a result of the September 11, 2001, terrorist attacks in New York City, claiming to have suffered business-related injury because the finance company that he used was located in New York and had stopped financing manufactured homes because of the tragedy. The investigation disclosed that the finance company was located in Vermont, not New York, and, although it had stopped financing manufactured homes in September 2001, the decision had nothing to do with the terrorist attacks in New York City. The investigation further disclosed that the man used the proceeds of the disaster loan to pay himself \$405,000, allegedly for an officer loan, despite the fact that he signed a Standby Agreement as part of his Loan Authorization and Agreement. This investigation was originally referred to the OIG by SBA's South Carolina District Office. The SBA OIG is conducting this investigation jointly with the Federal Bureau of Investigation (FBI).

SBA Proposes Debarment of Former Attorney. On May 15, 2006, SBA sent a Notice of Proposed Debarment to a former Mamaroneck, New York attorney. The proposed debarment 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 in New York City. 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. The Notice proposed to debar the former attorney for three years.

Business Loan Programs

OIG Issues Report on SBA Guaranteed Loan. On May 17, 2006, the OIG issued a report on an audit of an SBA guaranteed loan. The objective of the audit was to determine if the lender originated, serviced, and liquidated the purchased loan in accordance with SBA rules and regulations. The audit found that the lender did not disclose a material fact to SBA regarding the lack of independence of the company that performed the valuation of the assets purchased with loan proceeds. The lender also made a false statement to SBA regarding the same company in connection with the asset injection valuation. These deficiencies were not detected during the guaranty purchase process. As a result, SBA erroneously paid the lender \$373,258 on the loan guaranty. We recommended that SBA seek recovery of the purchase guaranty amount from the lender. The lender and SBA provided responses to the draft report. The lender disagreed with the finding and recommendation, claiming that the valuator was independent of the borrower and that SBA was aware of the potential conflict prior to loan approval. However, the lender did not provide a viable basis for its conclusions. SBA management agreed with the recommendation to recover the guaranty purchase amount.

Illinois Business Owner Charged. On May 15, 2006, the president and partial owner of Mount Prospect, Illinois, electric company was charged in a Criminal Information with one count of filing a false federal income tax return. The Information alleged that the man, on behalf of his company, filed a false 2001 U.S. Tax Return for an S Corporation (Form 1120S) that fraudulently represented \$430,500 as part of the cost of goods sold. The investigation disclosed that the man's cousin falsely represented to the SBA that \$430,500 in electrical supply sales had been made to the man's company. The man then falsely claimed the \$430,500 in purchases from the cousin's business on the company's tax return. This scheme affected the approval of a \$1.1 million SBA loan to the purchasers of the cousin's business by making the business appear more profitable than it actually was. The cousin was previously charged with one count of wire fraud. The SBA OIG conducted this joint investigation with the FBI.

Business Owner Pleads Guilty. On May 17, 2006, a Texas business owner pled guilty in the Southern District of Texas to one count of false statements. The OIG's investigation revealed that the man applied for a \$308,000 SBA-guaranteed loan to purchase a convenience store. During the application process, he submitted an SBA Form 912, Statement of Personal History, on which he falsely indicated that he was a U.S. citizen. Later, he applied for an additional \$870,000 SBA-guaranteed loan on behalf of his business. During this application process, he falsely indicated that he had no previous SBA debt and failed to disclose to the lender the outstanding SBA-guaranteed loan. The SBA OIG conducted this joint investigation with the Department of Homeland Security, Immigration and Customs Enforcement, and Texas Alcohol Beverage Commission.

Texan Man Pleads Guilty. On May 22, 2006, a Houston, Texas, man pled guilty to one count of bank fraud in connection with a fraudulent scheme to secure a \$1 million SBA-guaranteed loan from a Houston area bank to purchase a convenience store. The man had been indicted along with four other individuals, including a loan broker, on September 20, 2005. The man admitted to his role in a fraudulent scheme involving the submission to the lender of an inflated purchase contract, which falsely showed a sales price of \$1,320,000 for the convenience store, when the true purchase price was only \$788,617. Three of the four other co-defendants pled guilty in May 2006. The fifth and last defendant is believed to be in Pakistan. A warrant for his arrest remains outstanding.

Government Contracting and Business Development

OIG Issues Management Advisory Report. On May 23, 2006, the OIG issued a management advisory report as a result of a follow-up review of a 2003 audit of the HUBZone program. The previous audit recommended that a plan be developed and implemented to conduct an adequate number of program examinations each year to protect program integrity and lessen opportunities for contracting fraud. A program examination plan was subsequently developed and implemented, and the Agency reported that final action was completed on that recommendation in November 2004.

During our follow-up review, we found that while the program office had put in place both program

examination and recertification processes to ensure that only eligible firms participate in the program, the results of those processes contrasted sharply with the relatively high 70 percent approval rate of initial applications. Specifically, our review found that: (1) over 56 percent of firms were decertified or proposed for decertification as a result of program examinations; (2) over 81 percent of firms were decertified or proposed for decertification as a result of the three-year recertification process; (3) firms proposed for decertification as a result program examinations were not processed timely; (4) recordkeeping practices related to the program examination and recertification processes were lacking; (5) a request to the Federal Acquisition Regulation Council to revise HUBZone contract certifications was not being processed in a timely manner; and (6) system modification requests in the Federal Procurement Data System-Next Generation needed to measure HUBZone program performance were not implemented. While the implementation actions in items 5 and 6 are outside of SBA's direct control, SBA needs to monitor progress to encourage timely implementation.

The OIG made five recommendations to improve program recordkeeping, management, and monitoring. The Associate Administrator for the HUBZone Program had concerns regarding some of the conclusions found in the report, but generally agreed with the report's recommendations.

Agency Completes Final Action on Recommendation Made in Review of the Small Disadvantaged Business (SDB) Program (Report 5-04). The Agency reported that it completed the following final action. The Office of Government Contracting and Business Development (GCBD) has developed and implemented procedures to: (1) Require SDB reviewers to query the Credit Alert Interactive Voice Response System (CAIVRS), a system for checking delinquent Federal debt, to check all applicants for defaulted loans; (2) Update the SDB eligibility reviewer checklist to include a review of affirmative answers on the SBA Application Form; (3) Require SDB Eligibility Reviewer write-ups to address affirmative answers found on the SBA Application Form; and (4) Remind reviewers that "all applicants found to have Federal loan defaults will be denied certification." Additionally, the Program Office sent out a letter to an SDB certified company notifying it that it will be de-certified. The Central Contracting

Registry (CCR) now shows that the company's SDB certification has expired. Final action has been completed on six of the report's 11 recommendations.

Agency Management

Agency Completes Final Action on Recommendation Made in Management Advisory Report – SBA Needs to Implement a Viable Solution to its Loan Accounting System Migration Problem (Report 5-29).

The Agency reported that it has completed the following final action. The Office of the Chief Information Officer (OCIO), in conjunction with the Office of the Chief Financial Officer, explored the feasibility of charging each individual SBA office for their use of legacy applications when newer and more economical alternative computing capabilities exist. OCIO has identified the individual offices using the legacy applications and the types of legacy applications used. The OCIO has developed the methodology and has built a system to collect the required data to calculate the costs charged back to the individual offices. Four other recommendations contained in report remain open.

Agency Completes Final Action on Recommendation Made in Audit of the Consolidation of SBA Systems Subject to FISMA (Report 5-19). The Agency reported that it has completed the following final action. OCIO, in conjunction with GCBD, has reclassified the Dynamic Small Business Search (Pro-Net) from a "major" IT system to a "non-major" IT system. This was done per the guidance set forth in OMB Circular A-11, Section 300.4. All recommendations contained in the report have been completed.

Agency Completes Final Action on Two Recommendations Made in Audit of SBA's Information Systems for FY 2004 (Report 5-12). The Agency reported that it has completed the following final actions. OCIO has strengthened controls for requesting and approving access to the Agency's accounting system and periodically traced all access request forms to active user accounts. OCIO has also developed program changes for the Loan Accounting System (LAS) that force users to change their passwords every 90 days (in accordance with Agency policy) and locks out accounts after three to five failed log-in attempts by the user. 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 five Agency initiatives, including proposed legislation, Agency Standard Operating Procedures, and Agency notices containing directives to its employees.

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 these documents please contact:

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