



## Office of Inspector General U.S. Small Business Administration

November 2005 Update

### *Agency Management*

SBA FY 2005 Financial Statement Audit. On November 15, 2005, the OIG issued an audit of SBA's FY 2005 financial statements prepared by the independent certified public accounting firm of Cotton & Company LLP. The auditor issued an unqualified opinion on SBA's FY 2005 financial statements. The auditor also reissued its prior year conclusions which included an unqualified opinion on SBA's statement of budgetary resources and qualified opinions on SBA's FY 2004 balance sheet and statements of net costs, changes in net position, and financing. In its report on internal controls, the auditor noted three issues that it considers reportable conditions: (1) Financial Management and Reporting Controls; (2) Office of Disaster Assistance Administrative Expenditure Controls; and (3) Agency-Wide Information Systems Controls. The auditor further stated that the combined issues described in the first reportable condition are a material weakness under American Institute of Certified Public Accountants (AICPA) and Office of Management and Budget (OMB) standards. The auditor also concluded that SBA's control over performance measures did not ensure accuracy and reliability, as required by OMB Circular A-136 and prevailing accounting literature. In the *Independent Auditor's Report on Compliance with Laws and Regulations*, the auditor concluded that SBA was not in substantial compliance with the Federal Financial Management Improvement Act (FFMIA) because SBA was not in substantial compliance with Federal financial systems requirements, Federal accounting standards, or the U.S. Standard General Ledger at the transaction level.

SBA management generally agreed with the recommendations and was pleased that the Agency received an unqualified opinion on the FY 2005 statements.

### *Business Loan Programs*

Attorney and Loan Packager Sentenced. On October 20, 2005, pursuant to prior guilty verdicts returned by a Federal trial jury in the Northern District of Illinois, an attorney and an SBA loan-packager/business broker, were sentenced in U.S. District Court for convictions relating to conspiracies and schemes to defraud SBA and a non-bank participating lender, and to obstruct justice. A corporation co-defendant was also found guilty at trial, but was granted a sentencing continuance pending a hearing. The attorney was sentenced to 12 months and one day imprisonment and 2 years of supervised release, and was ordered to pay a \$40,000 fine and a \$100 special assessment. The loan packager was sentenced to one year probation with 6 months home detention and electronic monitoring. He was also ordered to cease any future involvement or affiliation with SBA programs and to pay a \$2,400 fine and a \$100 special assessment. Both of the defendants and the corporation had been found guilty for their involvement in a multi-faceted fraudulent scheme relating to a \$1.25 million SBA business loan for the purchase of an Illinois restaurant. This case was initiated based upon referrals from the Illinois District Office and an anonymous complaint. The OIG is conducting this joint investigation with the Federal Bureau of Investigation (FBI) and the Internal Revenue Service Criminal Investigations Division.

Illegal Alien Indicted and Arrested in Illinois. On November 10, 2005, a Pakistani foreign national residing in the U.S. illegally was indicted by a Federal grand jury in the Northern District of Illinois. The Pakistani, who is the former president of a gasoline/convenience store business located in Maywood, Illinois, had obtained an SBA-guaranteed loan in the amount of \$160,000. The indictment charges him with three counts of bank fraud in connection with a scheme to make false claims of U.S. citizenship on multiple loan application documents in order to wrongfully obtain loan funds. The loan to the

gasoline/convenience store defaulted, ultimately resulting in a gross principal loss exceeding \$120,000. An arrest warrant was issued pursuant to the indictment. On November 17, 2005, the Pakistani was arrested by special agents from the OIG and the U.S. Department of Homeland Security, Bureau of Immigration and Customs Enforcement (DHS/ICE). He will face concurrent deportation proceedings. The OIG is conducting this joint investigation with the DHS/ICE.

Arrests Made in Texas Loan Case. On November 15, 2005, the owner of a company holding several gas stations in Texas was arrested by agents from the SBA OIG and the Texas Alcohol Beverage Commission (TABC). He was charged in a criminal complaint with making false statements and the unauthorized use of a TABC permit. Subsequent to his arrest, he admitted that he falsified a capital injection to obtain a \$640,000 SBA-guaranteed loan to purchase four food stores and transferred ownership of the properties without notifying the SBA. On November 17, 2005, a second man was arrested by OIG and TABC agents. He had also been charged in a criminal complaint with false statements and unauthorized use of a TABC permit. He had entered into an agreement with the company owner to purchase one of the food stores without disclosing the sale to either SBA or the lender. Allegedly, the second man then sold the store to a third party but continued to renew the TABC permit, claiming ownership. This case was originally referred to the OIG by the TABC. The OIG is currently conducting this joint investigation with the TABC and additional arrests/prosecutions are anticipated.

Agency Completes Final Action on Two Recommendations Made in Equity Injection Report. The Agency reported that it completed the following final actions. In response to our recommendation that adequate training be provided SBA and lender employees, the Office of Financial Assistance (OFA) believes that, in the absence of funding for SBA-sponsored training, the training offered by private vendors is adequate and will be used to provide credit analysis training to SBA staff. If funding is secured in the future, OFA will ensure that the training for its employees is standardized. The four issues concerning documentation of equity injection were added to Standard Operating Procedure 50 10, which is now in final clearance. Actions for all recommendations in this report are now complete.

## ***Small Business Investment Company Program***

Former SBIC CEO Served with Complaint and Summons. On November 1, 2005, the former CEO and manager of a Missouri Small Business Investment Company (SBIC) was served with a complaint and a summons. Located in St. Louis, Missouri, the SBIC was licensed by SBA. A civil complaint had been filed in the U.S. District Court for the Eastern District of Missouri on October 12, 2005. The complaint alleges breaches of fiduciary duty through negligence, gross negligence, and conscious disregard of the best interests of the SBIC. The complaint details the improper conversion of funds by the former CEO for his own personal benefit, to the detriment of the SBIC. The complaint seeks recovery of \$393,744 in actual damages, plus interest. This case was referred to the OIG by SBA's Office of SBIC Liquidations. The OIG is conducting this investigation jointly with the FBI.

Owner of SBIC Pleads Guilty. On November 3, 2005, a part owner of an SBIC technology fund licensed by the SBA and located in Princeton, New Jersey, pled guilty by way of an information to making a false entry in the books, reports, and statements of the SBIC. His wife, also a part owner of the SBIC, had previously pled guilty to interstate transportation of stolen or fraudulently obtained property in connection with her role in stealing more than \$1.9 million from the SBIC. The husband converted at least \$5 million received from SBA for his personal benefit. Sentencing is scheduled for January 27, 2006. This case was originally referred by the SBA's Investment Division. The OIG is conducting this investigation jointly with the FBI.

## ***Government Contracting and Business Development***

Business Owner Served Summons in SBIR Case. On October 17, 2005, a technology company and its owner were served with a summons in a civil case. The summons, served by SBA OIG agents, alleged that the owner, through his company, made false statements and engaged in a pattern of fraudulent conduct to improperly obtain funds from Small Business Innovative Research (SBIR) contracts awarded to the company by the U.S. Army, U.S. Air Force, and National Aeronautics and Space Administration (NASA). Specifically, it is alleged that the owner of the company, without making

proper disclosures, billed different Federal agencies for the same work, billed for work that was not performed, and falsified time sheets and research logs to ensure optimum funding under each contract. As a result of his improper conduct, the U.S. Government paid the company approximately \$2 million to which it was not entitled. The SBA OIG is conducting this joint investigation with the NASA OIG, the U.S. Postal Inspection Service, the U.S. Army Criminal Investigations Division, and the Defense Criminal Investigative Service (DCIS).

8(a) Company Manager Sentenced. On November 4, 2005, a former general operations manager of an 8(a) environmental company located in Chesapeake, Virginia, was sentenced to 3 months incarceration, 3 months home detention, 2 years probation, a \$10,000 fine, and a \$300 special assessment fee. The former manager had previously pled guilty to one count of making a material false statement, two counts of violating the Clean Air Act, and two counts of aiding and abetting. The false statement count related to his having falsely stated to the Occupational Safety and Health Administration of the Department of Labor that he had successfully completed training for hazardous waste operations and emergency response accreditation when, in fact, he had not. The other counts related to his having knowingly removed regulated asbestos-containing material in an improper manner at a junior high school and a residential development. This case was originally referred to the SBA by the Department of Justice, Washington, DC. The OIG conducted this investigation jointly with the FBI, DCIS, the Environmental Protection Agency/Criminal Investigation Division, the Army/Criminal Investigation Division, and the NASA OIG.

## *Other*

Agency Completes Final Action on Two Recommendations Made in Audit of SBA's Special Appropriation Grants. The Agency reported that it completed the following final actions. (1) implemented corrective measures to prevent the identified deficiencies from reoccurring in the future; and (2) took steps to circulate for clearance by November 30, 2005, the update to SOP 00 11 1 on Small Purchases, Contracts, Grants and Cooperative Agreements, which will contain policies and

procedures for the review, monitoring, and oversight of special appropriation grants. Five other recommendations made in the audit report remain open.

## *Statutory/Regulatory/Policy Reviews*

In 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 12 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, Peter L. McClintock, Acting Inspector General.

The OIG has established an e-mail address ([oig@sba.gov](mailto: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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