



Office of Inspector General Small Business Administration

October 1999 Update

Business Loans

OIG Inspection Report Examines Oversight and Operation of Certified Development Company (CDC) Program. The inspection found that **SBA's monitoring of CDCs needs tightening to be effective.** The report contains recommendations for strengthening internal controls, and improving effectiveness and timeliness of program delivery. It focuses on CDC reporting requirements, contractual agreements with service providers, Section 504 loan fees charged to borrowers, compliance with program rules, and performance measurement. To improve oversight, SBA should (1) require more specific data in the annual reports submitted by the CDCs, (2) make more effective use of those reports for overseeing CDC activities, (3) clarify its policy on the contracting out of CDC services to for-profit companies, (4) improve monitoring of contracts, (5) track fees charged to borrowers more closely, (6) ensure that district offices approve Accredited Lenders Program (ALP) loan applications within the required 3-day time period, (7) revoke the ALP status of CDCs that submit loan packages that do not meet ALP standards, and (8) ensure that district offices perform a site visit of each CDC at least once every 3 years.

California Loan Brokerage Firm Yields Further Results. More actions have resulted from the investigation of the Inglewood, California, loan brokerage firm.

1 A Harbor City, California, tax preparer, was sentenced on July 19, 1999, to serve 15 months in prison and 5 years on supervised release. He was also ordered to pay \$15,000 in restitution. He previously pled guilty to three counts of aiding and abetting the **making of false statements to a federally insured lender.** He admitted assisting principals of the loan brokerage firm preparing fraudulent tax returns (some fictitious, others altered), fraudulent personal financial statements, fictitious profit and loss statements, and other false documentation for these clients. He admitted having known that the false documents would be included in application packages being submitted for SBA-guaranteed loans. The charges address the preparation of false documents in three loan application packages, which resulted in the approval of SBA-guaranteed loans totaling \$2.5 million. (*Updated from July 1998 Update.*)

2 A former co-owner of a gas station in West Covina, California, gas station, was sentenced on August 2, 1999, to serve 1 month in prison, 5 months on home detention, and 5 years on supervised release. He was also

ordered to pay \$132,000 in restitution. He previously pled guilty to one count of **making false statements to a federally insured lender**, for submitting altered income tax returns for 1987 through 1989 with his application for a \$1 million SBA-guaranteed loan. His co-borrowers (who were previously sentenced for their part in the fraud) subsequently defaulted on the loan. After all liquidation efforts were completed, SBA charged off a balance of approximately \$500,000. (*Updated from July 1998 Update.*)

3 A former owner of a fish market in Castaic, California, pleads guilty on June 22, 1999, to one count of **making false statements to a federally insured lender**. He submitted altered individual income tax returns for 1988-1990 as part of his application for a \$1 million SBA-guaranteed loan. He subsequently defaulted on the loan. The real property and business assets were sold, leaving an unpaid balance of \$505,663, which was ultimately charged off by SBA. (*Updated from the May 1999 Update.*)

Florida Proprietor Pleads Guilty to Making Material False Statements. A credit repair and counseling firm in Jacksonville, Florida, entered a guilty plea on October 13, 1999, to an information charging her with one count of **making material false statements** to influence the disbursement of an \$80,000 LowDoc loan to her business. She misrepresented, on four SBA Settlement Sheets (Form 1050), that she intended to use loan disbursements to purchase fixed assets. In fact, she falsely negotiated joint-payee loan checks when she purchased equipment from third parties, and then returned all or some of the equipment for refunds. OIG initiated this investigation based on information received from SBA's North Florida District Office.

Disaster Assistance

Virgin Islands Resident Charged in Criminal Information. A resident of St. Thomas, Virgin Islands was charged in a criminal information filed on October 27, 1999, with one count of **making a false statement to SBA** to obtain a \$34,000 disaster loan. She had applied for the loan to repair damage done to her home as a result of Hurricane Marilyn. The loan application was in the name of herself and her mother, but OIG's investigation documented that her mother had died 9 months before the application was submitted. The investigation revealed that she had forged her deceased mother's signature and provided false financial information in the loan application package. OIG opened the case based on a referral from SBA's Disaster Assistance Area 1 Office.

California Man Sentenced for Making False Statements to Federally Insured Financial Institution. A Canoga Park, California, resident was sentenced on August 2, 1999, to serve 5 months in prison, 5 months in a half-way house, and 5 years on supervised release. He was also ordered to pay \$247,557 in restitution (88 percent to SBA). He had pled guilty to one count of **making a false statement to a federally insured financial institution**. Following the 1994 Northridge earthquake, he had received a \$48,000 disaster home loan from SBA for damage to his personal property and condominium. Later in 1994 he received a \$255,950 SBA-guaranteed loan for the purchase of a self-service laundry in Huntington Park, California. OIG initiated its investigation based on a referral from an attorney in SBA's Disaster Assistance Area 4 Office. The investigation disclosed that, in applying for the business loan, he submitted false statements to the participating lender bank. He claimed to be employed at a salary of \$52,000; in fact, he was unemployed at the

time and had never been employed by the named employer. He also did not disclose to the bank that, in violation of the requirement to use non-borrowed funds, he had used proceeds from the disaster loan as the source of the down payment for the purchase of the laundromat. The investigation further revealed that he had submitted false information to SBA in support of the loss of personal property in the disaster home loan. The investigation showed that most of the personal property claimed as damaged had actually been moved to another site. SBA loss verifiers were shown only minor broken items and were told that the rest had been cleared away prior to their visit. Both loan balances were charged off after his subsequent Chapter 7 bankruptcy discharge; the total loss to SBA was approximately \$245,000. *(Updated from January 1999 Update.)*

Colorado Telemarketer Sentenced for Making False Statements. The owner of a telemarketing company in Denver, Colorado, was sentenced on October 8, 1999, to serve 2 ½ years in prison and 2 years on supervised release and to pay \$1.5 million in restitution. He was previously convicted on two counts of **making false statements to SBA**. He obtained a \$1.5 million SBA disaster loan after his company sustained damage from the Northridge, California, earthquake. He relocated his business to Denver and falsely reported (submitting invoices and other documents to SBA as “proof”) that he used \$1.2 million of the loan proceeds to purchase new equipment from a multimedia company. OIG’s investigation found that he controlled this company and that most of the equipment listed on the company’s invoices was salvaged out of the earthquake-damaged building in California or was already owned by him or his other companies. OIG initiated this investigation based on an anonymous telephone call. *(Updated from July 1999 Update.)*

Small Business Investment Companies

Four Men Involved with New York Specialized Small Business Investment Company Sentenced for Conspiracy. Four men were sentenced in Federal District Court in Manhattan on October 18, 1999. The first was sentenced to serve 78 months incarceration to be followed by 3 years probation, and was ordered to pay \$11,179,513 in restitution to defrauded Government entities, including \$100,000 to SBA. The second man was sentenced to serve 70 months incarceration to be followed by 3 years probation, and was ordered to pay \$10,118,182 in restitution. The third man was sentenced to serve 57 months incarceration to be followed by 2 years probation and was ordered to pay \$11,089,721 in restitution. The fourth man was sentenced to serve 30 months incarceration to be followed by 2 years probation, and was ordered to pay \$522,977 restitution. The sentences were the result of their 1999 convictions on 21 counts involving charges of **conspiracy, embezzlement of Federal program funds, making false statements, mail fraud, wire fraud, mortgage fraud and money laundering.** The men are leaders of the incorporated Rockland County, New York, village of New Square, which has been the recipient of millions of dollars in benefits from various Federal programs, including SBA’s Small Business Investment Company program. They had been indicted in 1997, along with the fourth man’s father, who was one of New Square’s founders, and the son of New Square’s mayor. The fourth man’s father and the mayor’s son fled after being indicted. The fourth man’s father was arrested in Israel earlier this year and is fighting extradition to the United States. An arrest warrant was issued for the mayor’s son. The 5-year investigation disclosed that the defendants participated in a number of fraudulent schemes to obtain millions of dollars through SBA’s

Specialized Small Business Investment Companies (SSBIC) program and other Federal and State grant, loan, and subsidy programs. The fourth man, a board member of SSBIC, misappropriated SBA funds through Square Deal in which SBA had invested \$1 million. In violation of Federal regulations, he participated in extending loans to small businesses affiliated with the SSBIC's officers and directors, and concealed these improper loans by submitting fraudulent documents to SBA. He also loaned SBA funds to enterprises that were not independently controlled by private business owners but affiliated with a religious school in the village, a not-for-profit entity ineligible to receive SBA funds. SSBIC also made loans to small businesses that, in turn, improperly paid a portion of the loan proceeds to the religious school or to related entities. The other defendants conspired to facilitate these illegal transactions. The Office of the U.S. Attorney for the Southern District of New York requested SBA/OIG to join its investigation with Internal Revenue Service and OIGs of the Departments of Education and Housing and Urban Development. *(Updated from January 1999 Update.)*

Section 8(a) Business Development

President of New York Contractor Pleads Guilty to Conspiracy, Making Material False Statements and Bank Fraud. The president of a Long Island, New York, general construction contractor pled guilty on September 7, 1999, to one count each of **conspiracy**, **making material false statements** to SBA, and **bank fraud**. He admitted that, as part of the company's 1995 application to obtain certification into SBA's Section 8(a) program, he had falsely stated on an SBA Form 912, Statement of Personal History, that he had never been arrested or charged with a crime. The investigation disclosed that local authorities in Maryland had arrested him on

theft charges in 1986. He also admitted submitting documents containing inflated income information to induce a federally insured financial institution to extend a \$50,000 line of credit to his company. In 1997, the company was awarded a \$378,000 Section 8(a) contract to do work at the Federal Correctional Institution in Otisville, New York. He also admitted that he and one or more unnamed others conspired to defraud the United States by submitting fraudulent payment and performance bonds and falsified payroll reports in connection with the Section 8(a) contract *(Updated from August 1999 Update.)*

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Entrepreneurial Development

Audit of Women's Business Development Center Finds Unallowable Costs. An audit of a Women's Business Development Center, **identified \$167,448 of claimed costs that were unallowable.** The audit also found that the grantee used grant funds to purchase equipment and supplies, and entered into consulting agreements with board members. In addition, the grant period had expired and there were unexpended Federal funds totaling \$60,007. Of the amount identified as unallowable, \$142,779 was attributed to lack of documentation to support the expenditures. The cooperative agreement required the grantee to maintain complete and accurate records, including supporting documentation. Furthermore, the grantee did not meet the cash match requirements. The audit recommended reimbursement for the unallowable cost. Since the project had ended, no recommendation was necessary for the conflicts of interest. The Assistant Administrator for Administration agreed with the findings and recommendations.

Agency Management and Financial Activities

Audit Memorandum Issued on SBA's Electronic Records Management. After completing a survey, OIG decided not to perform an audit of SBA's electronic records management (ERM) because SBA's ERM program was in too early a stage of development. An audit memorandum was issued with the results of the survey which found that **SBA had not implemented a comprehensive ERM program** (i.e., complete inventories and schedules were not developed, program offices were not aware of ERM requirements, and ERM guidance was lacking). The survey recommended that the Associate Deputy Administrator for Management and Administration implement an ERM program that meets the requirements of 36 CFR 1222, 1228; and 1234. In response to the audit memorandum, the ADA/MA indicated her awareness of the importance of ERM.

The following identifies the use of adjectives in these **Updates** to describe tax returns fraudulently submitted in support of loan applications:

Fictitious tax returns: The applicant submits "copies" of tax returns never filed with the IRS.

Altered tax returns: The applicant submits altered copies of tax returns actually submitted to the IRS.

Bogus tax returns: The applicant submits tax returns containing false information to both the IRS and SBA.

Most audit and inspection reports can be found on the Internet at:

WWW.SBAONLINE.SBA.GOV/IG/REPORTS.HTML

Other IG related material can be found at:

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The Activity Update is produced by the SBA/OIG, Phyllis K. Fong, Inspector General.

Comments or questions concerning this update or request for copies of OIG audits, inspections, or other documents should be directed to Donna M Ching, SBA/OIG, 409 Third Street, SW, Washington, DC, 20416-4110.

Telephone number (202) 205-6580

FAX number (202) 205-7382

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Editor's Notes: