Office of Inspector General
U.S. Small Business Administration

July 2009 Update

Agency Management

<u>OIG Issues Report on the Loan Management and Accounting System (LMAS) Modernization Project</u>. On July 30, 2009, the OIG issued a report, *Review of Allegations Concerning How the Loan Management and Accounting System Modernization Project is Being Managed*. This review was initiated based on a complaint received by the OIG. The review confirmed allegations in the complaint that: (1) the project-level Quality Assurance (QA) process was not independent from project management staff; (2) a process had not been established for accepting contract deliverables until January 2009; (3) several deliverables were behind schedule; (4) contractors participated in meetings and were assigned tasks without being cleared or trained on SBA security procedures; and (5) the project's risk management process was immature.

The OIG recommended that SBA: (1) take steps to modify the LMAS contract to require that the QA/IV&V contractor report all findings and recommendations to the Program Manager *and* an independent QA Manager designated by the Chief Information Officer; (2) establish a well-defined process for reviewing and accepting LMAS deliverables; (3) ensure that contractor employees are not allowed to work on LMAS until they have been properly vetted in accordance with SBA policies and procedures; (4) revise the LMAS risk register to include all fields identified in the LMAS Risk Management Plan and key information that is currently missing in the risk register; and (5) establish an enterprise-wide QA function to ensure that all IT projects comply with Agency quality standards.

<u>OIG Issues Report on SBA Contracting Personnel</u>. On July 6, 2009, the OIG issued an audit report, *Office of Business Operations Contracting Personnel Qualifications and Warrant Authority*. The objectives of the audit were to determine whether: (1) SBA contracting personnel had met the education, training and experience requirements for their certification levels; and (2) SBA's Office of Business Operations (OBO) properly managed the issuance and termination of contracting officer warrant authority.

The OIG found that, while six contracting officers had contracting certifications, OBO issued new warrants to them without documentation of the specific courses showing that they had the education, training, and experience to support their certification levels. Also, the acquisition analyst administering the certification program for SBA had not been granted administrative rights to the Acquisition Career Management Information System (ACMIS), which limited her ability to manage certification program compliance. As a result, the Agency was not in compliance with Office of Management and Budget (OMB) requirements to assure that contracting officers were qualified to properly administer contract actions, including $20 million in contracts planned under the Recovery Act, and could not readily identify future training needs. In addition, OBO did not have established processes or sufficient records for (1) linking warrant authority to certification levels, and (2) controlling the issuance and termination of contracting officer warrants. This occurred because managers and supervisors within OBO did not ensure that the certification program was fully implemented and that a proper control environment was established for the warrant process.

To address these issues, the OIG recommended that the Agency: (1) hold contracting personnel accountable for entering training data in ACMIS to support their certification levels; (2) monitor OBO's compliance with OMB's certification program requirements; (3) update the official designation of an

Acquisition Career Manager (ACM) and seek administrative rights to ACMIS for that individual; (4) revise its procedures to link Federal acquisition certification levels to contracting officer warrant authority; and (5) establish procedures to better control the issuance and termination of warrants.

Business Loan Programs

OIG Issues Report on the SBA's Fiscal Year 2008 Improper Payment Rate. On July 10, 2009, the OIG issued an audit report, *SBA's Fiscal Year 2008 Improper Payment Rate for the 7(a) Guaranty Loan Program*. The Improper Payments Information Act (IPIA) of 2002 requires that Federal agencies review their programs and activities annually, identify programs that may be susceptible to significant improper payments, estimate amounts improperly paid, and report on the amounts of improper payments and actions to reduce them. The objectives of the OIG audit were to determine: (1) whether SBA's FY 2008 estimate of the improper payment rate for the 7(a) program was accurate; (2) if the estimate was not accurate, the reasons why; and (3) whether recovery goals for FY 2007 and FY 2008 were met.

The OIG found that SBA's improper payment estimate for FY 2008 was not accurate because it significantly understated the level of improper payments in the 7(a) program. SBA reported that improper payments were 0.53 percent of FY 2008 program outlays, while the OIG estimated the improper payment rate to be 29 percent (approximately $248 million) of the $869 million in loan guaranties purchased between April 1, 2007, and March 31, 2008.

The OIG reviewed a sample of 30 loans and found that 14 of the loans lacked evidence to support lender compliance with SBA origination, servicing, and/or liquidation requirements, resulting in improper payments totaling $723,293. In contrast, SBA reported improper payments of $4,468 on only 2 of the sampled loans. Additionally, for all 30 loans, outstanding ongoing guaranty fees due to SBA (approximately $300 on average) were not offset against purchase amounts paid to lenders. The OIG also found that improper payments on three other loans reported by SBA's National Guaranty Purchase Center, totaling $1.6 million, were inappropriately overturned by the Office of Financial Assistance (OFA). Had this not occurred, the improper payment rate reported to the OMB would have been 10.75 percent rather than the 0.53 percent reported. Finally, the OIG found that OFA did not timely recover improper payments identified during its FY 2007 and FY 2008 improper payments reviews, and had only recovered about 1 percent of the improper payments identified in these 2 years.

The OIG made a number of recommendations to the Agency, including that it seek recovery of $2.3 million in identified improper payments and report to OMB the revised improper payment rate calculated by the OIG for FY 2008.

Results of Ongoing Investigation. The following case is part of an ongoing investigation, being conducted jointly with the U.S. Secret Service (USSS), relating to a scheme in which a non-bank lender's former executive vice president and others not employed by the lender conspired to fraudulently qualify loan applicants for SBA-guaranteed loans.

- On June 19, 2009, a Philadelphia man was sentenced to 21 months imprisonment, immediate restitution of $953,736, and a $100 special assessment fee. In addition, he was ordered to be transferred to the Department of Homeland Security, Immigration and Customs Enforcement (DHS-ICE) for deportation immediately following his term of imprisonment. He had previously pled guilty to one count of mail fraud as charged in a superseding Information. A prior indictment charged him and three other individuals with multiple counts of wire fraud in connection with schemes to defraud the SBA and one of its preferred lenders. One such scheme involved a $1,240,000 SBA loan to an Illinois corporation (of which he was corporate secretary and 50% owner) for purchase of a gasoline station property located in Chesterton, Indiana. The scheme was facilitated by a loan agent who brokered sales of gas stations and hotels in the Midwest and obtained financing for the new owners. The investigation revealed that the loan agent created counterfeit statements for his clients falsely showing that they possessed adequate cash funds for their required equity injections.

Michigan Doctor Sentenced. On June 30, 2009, a Michigan doctor was sentenced to 24 months probation, 200 hours community service, restitution of

$739,012.48, and a $100 special assessment fee. He previously pled guilty to a one-count Information charging him with making a false statement for the purpose of influencing the action of the SBA. An investigation disclosed that he signed a HUD-1 Settlement Statement falsely representing that he paid a $510,000 deposit for the purchase of two gasoline stations.

Government Contracting and Business Development

OIG Issues Report on 8(a) Awards to Alaska Native Corporation (ANC) Firms. On July 10, 2009, the OIG issued an audit report, *Growth in 8(A) Awards to Alaska Native Corporation Firms Has Disadvantaged Other Program Participants and Challenged SBA's Oversight Capability*. The objectives of the audit were to: (1) identify 8(a) contracting trends relative to ANC-owned firms; (2) determine whether 8(a) contracting advantages have improved economic opportunities for Alaska Natives; and (3) assess SBA's ability to effectively monitor ANC compliance with program rules.

The OIG reported that long-term 8(a) contracting trends show a continued and significant increase in obligations to ANC-owned participants, many of which were made through sole-source contracts. This growth suggests that the special advantages afforded ANC participants may be limiting the number of non-ANC disadvantaged firms that secure 8(a) contracts. In addition, while the 8(a) program is undeniably benefiting Alaska Natives, the audit showed that a few ANC participants received a disproportionate share of the 8(a) obligations. Further, because studies have shown that sole-source contracts do not always provide the Government with the best value, it is questionable whether providing ANCs with contracting advantages under the 8(a) program is the most cost-effective way of assisting Alaska Natives.

Although designated by statute as disadvantaged, due to their association with their large parent corporations and affiliates, which often provide them access to capital and credit as well as management expertise, many ANC firms have clear advantages over other 8(a) program participants when competing for contracts. Requiring non-ANC small businesses to compete against these ANC participants appears to be inconsistent with the primary purpose of the 8(a) program of helping small disadvantaged firms develop the skills needed to compete in the American economy. However, SBA has not undertaken a program review to determine whether ANC participation is adversely impacting other 8(a) participants. The Agency has also been slow to expand and fully staff its oversight capabilities to address the complex nature of ANC business relationships and ANC growth in the program.

The report raised several issues for congressional consideration. Specifically, Congress may want to consider whether the statutory advantages given to companies owned by ANCs and other Indian tribes are consistent with the overall mission and intent of the program to benefit economically disadvantaged small businesses. Congress may also want to consider legislatively requiring that SBA determine whether ANC-owned firms have a substantial unfair competitive advantage before exempting them from the size affiliation rules and that ANCs report to SBA on how 8(a) revenues are benefiting Alaska Natives.

The report recommended that SBA conduct a program review to evaluate: (1) the extent to which growth in the ANC 8(a) participation has or will adversely impact other 8(a) firms and the overall effectiveness of the 8(a) program; and (2) whether firms owned by ANCs and Indian tribes should continue to be exempt from the cap on total sole-source awards. In addition, the Agency should: (1) centrally track 8(a) awards to joint ventures involving ANC participants and awards that are sole sourced to ANC-owned firms; (2) expedite completion of a management information system to increase its capability to oversee ANC participant activity; (3) finalize policies and procedures needed to implement GAO's recommendations; and (4) fully staff the Alaska District Office, as recommended by the OIG.

Georgia Woman Charged. On July 17, 2009, a Georgia woman and her company were charged in an Information with one count of making false statements to the SBA. The company supplied temporary staffing services to various Federal agencies and departments, including the Department of Veterans Affairs (VA) Consolidated Mail Outpatient Pharmacy (CMOP) in Leavenworth Kansas. It is alleged that she made false statements to the SBA so that her company could qualify for certification under Section 8(a) of the Small Business Act, a designation given to businesses owned and operated by socially and economically disadvantaged persons. Specifically, she concealed the involvement of her former employer, who was not a socially and economically disadvantaged person, in the management and operations of her company. Her false statements resulted in SBA certifying the company as an 8(a) company and allowing it to obtain 8(a) set-aside contracts valued at about $5.4 million with the CMOP. The OIG is conducting this investigation jointly with the Department of Justice (DOJ) Antitrust Division, the VA OIG, the Defense Criminal Investigative Service (DCIS), and the USSS.

Disaster Loan Program

<u>OIG Issues Report on Insurance Offsets on Disaster Loans</u>. On July 6, 2009, the OIG issued an audit report, *Application of Insurance Offsets on Disaster Loans for the Midwest Floods of 2008*. Under the Stafford Act, Federal Agencies administering disaster benefits must ensure that individuals receiving assistance have not already been compensated for their losses by another program, or from insurance or another source. The objective of the audit was to determine whether SBA properly reduced Midwest flood loan balances to reflect insurance offsets.

The OIG determined that SBA's Office of Disaster Assistance (ODA) did not correctly identify or offset insurance payments on 9 of 99 sampled loans, resulting in $126,876 in duplicate benefits. When the OIG informed ODA officials, or when they otherwise became aware of the duplicate benefits, they took action to offset $94,319 of the payments on 5 of the loans, but did not take steps to recover the duplicate benefits on the remaining 4 loans. The majority of the errors occurred because loan officers did not check with insurance companies to determine the amount of insurance that had been paid prior to each disbursement, as required.

The OIG recommended that ODA revise SOP 50 30 to require confirmation of insurance payments prior to loan approval and before the final disbursement. The OIG also recommended that ODA reduce the loan balances for the remaining 4 loans by the additional offset amounts identified in the report to prevent $32,557 in duplicate benefits.

<u>Boston Man Indicted</u>. On July 1, 2009, a Boston man was indicted in U.S. District Court for the District of Massachusetts on seven counts of visa fraud, four counts of wire fraud, one count of theft of government funds, and one count of Social Security fraud. He is alleged to have falsely claimed residence in New Orleans during Hurricane Katrina in order to receive a $40,000 SBA disaster loan. The loan defaulted without payment. He was also indicted for a visa fraud scheme as well as fraud related to the Federal Emergency Management Agency (FEMA) and the Social Security Administration (SSA). The OIG is conducting this investigation jointly with DHS-ICE, the DHS OIG, and the SSA OIG.

<u>Maintenance Supervisor Sentenced</u>. On July 8, 2009, a Mississippi community college maintenance supervisor was sentenced to 36 months probation, 100 hours community service, $179,400 in restitution to the SBA, $14,006 in restitution to the FEMA, and a $300 special assessment fee. He was previously indicted for making false statements on his applications for disaster benefits after Hurricane Katrina and pled guilty to one count of false statements and two counts of theft of government funds. Specifically, he indicated that his primary residence was in an area affected by the storm, when in fact, he resided in an area that was not affected. He fraudulently received $179,400 from the SBA and $14,006 from the FEMA. He also applied for a Mississippi Development Authority Homeowner Assistance Program Grant, but that application process was suspended pending the results of this investigation. The OIG is conducting this investigation jointly with DHS OIG, the U.S. Department of Housing and Urban Development (HUD) OIG, the Mississippi State Auditor's Office, and the Federal Bureau of Investigation (FBI).

<u>Louisiana Man Charged</u>. On July 10, 2009, a Louisiana man was charged via a criminal Information with one count of theft of government funds. He allegedly misrepresented to the SBA that he had contracted for repairs to his residence for damages caused by Hurricane Katrina when, in fact, he had only received an estimate for the repairs. Based on the misleading documentation he submitted, SBA approved a disaster loan for $63,500. That amount was later increased to $106,300. It is also alleged that he submitted copies of fraudulent checks in order to receive loan disbursements. The OIG is conducting this investigation jointly with members of the DOJ Hurricane Katrina Fraud Task Force.

This monthly update is produced by the SBA OIG, Peter L. McClintock, Acting Inspector General.

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