



Office of Inspector General U.S. Small Business Administration

April 2003 Update

Business Loan Programs

Texas Man Indicted for Bank Fraud, Conversion of Collateral, and Money Laundering. A resident of San Antonio, Texas, was indicted on April 1, 2003, in the Southern District of Texas, on one count of **bank fraud**, one count of **conversion of collateral pledged to SBA**, and one count of **money laundering**. According to the indictment, he submitted inflated income statements that misrepresented his net worth in connection with a \$213,000 SBA-guaranteed loan he obtained to start an ice cream business in Las Vegas, Nevada. It was further alleged that the defendant misrepresented the source of his required equity injection by concealing personal loans he obtained prior to funding. After his loan went into default, he allegedly concealed proceeds and converted collateral equipment to impede full liquidation of the collateral. During the investigation, a search warrant was executed at his residence where currency and checks in the amount of \$24,114.69 were seized. As a result of his loan defaulting, SBA sustained a loss of \$136,326. Criminal forfeiture proceedings will be brought to recover proceeds up to the amount of loss sustained by SBA. OIG conducted this investigation as part of a taskforce in Corpus Christi, Texas (the defendant's former residence), jointly with the Bureau of Alcohol, Tobacco, and Firearms; the Federal Bureau of Investigation (FBI); and the Internal Revenue Service.

Maryland Man Indicted for Bank Fraud. A Baltimore, Maryland, businessman was indicted on April 3, 2003, in the District of Maryland on one count of **bank fraud**. The defendant submitted an application for an SBA-guaranteed LowDoc loan in the amount of \$65,000 to establish a restaurant. On his application he falsely represented that he had never been charged or convicted of a criminal offense. The investigation revealed that he had numerous arrests and four convictions on his criminal record prior to his application. One of the key eligibility criteria for a LowDoc loan is good character, and loan officials at SBA stated that the loan guaranty would not have been approved if they had been aware of his criminal history. He defaulted on the loan after two payments. SBA refused to honor the guaranty on

the loan when the lender failed to provide the documents required for the purchase. The loss to the bank is \$49,382. This case was initiated as a result of the defendant making threatening remarks against the lender during a telephone call with the Baltimore District Office.

Ohio Man Convicted of Bankruptcy Fraud. A Lima, Ohio, man was found guilty on April 4, 2003, by a Federal Jury in the Northern District of Ohio, Western Division, to one count of **bankruptcy fraud** and one count of **concealment of assets from the bankruptcy trustee**. In May 2002, after being told that SBA's programs could not accommodate his request for direct SBA funding to assist in his business reorganization, he submitted a loan application to the Columbus, Ohio, District Office. To support his application, he obtained blank copies of SBA loan documents and fraudulently completed and filed false mortgages and promissory notes with the Allen County Recorder's Office in Lima, Ohio. These recorded documents falsely detailed a \$10.75 million loan from the SBA, including a mortgage on his rental properties, when SBA had not participated in any such transaction. On June 3, 2002, the defendant included these fraudulent documents with his "Plan of Arrangements," that he filed with the Bankruptcy Court in connection with his voluntary petition for relief under Chapter 11 of the Bankruptcy Code. This investigation was initiated based on a referral from the Columbus, Ohio, District Office and was conducted jointly with FBI.

U.S. Attorney Files Civil Suit Against Small Business Lending Company. A small business lending company entered into a settlement agreement on April 27, 2003, wherein they agreed to pay SBA \$200,000 to settle a civil suit filed by the U.S. Attorney's Office, Western District of Pennsylvania. In 1996, SBA guaranteed a \$385,000 loan made by the lending company to a restaurant to purchase machinery, equipment, and fixtures. The borrower defaulted on the loan shortly thereafter, and SBA purchased the guarantee for \$290,047. At liquidation, the former owner of the restaurant purchased the equipment for only \$11,000. SBA questioned the gross disparity between this amount and the amount originally loaned for the equipment, and alleged

that the equipment may have been improperly assessed at the time of the loan or missing at the time of liquidation. The investigation did not reveal any criminal violations, but confirmed that the lending company did not administer the loan properly. Specifically, the lending company disbursed the entire amount of the loan for the purchase of machinery, equipment, and fixtures without having it properly appraised. As the lending company refused to return any of money SBA paid to honor its guaranty, OIG recommended that SBA file a civil suit to obtain reimbursement of the guaranty payment. SBA agreed and the U.S. Attorney's Office filed a civil suit against the lending company in the Western District of Pennsylvania. This investigation was based on a referral from the Pittsburgh, Pennsylvania, District Office.

Georgia Vending Service Company President Pleads Guilty to Making Material False Statements and Bankruptcy Fraud.

The president of a vending service company in Marietta, Georgia, pled guilty on April 22, 2003, to one count of **making material false statements** and one count of **bankruptcy fraud**. The plea was a result of an indictment alleging that he failed to disclose a previous criminal history on an SBA Form 912 that was submitted to the financial institution with a \$500,000 loan application. He later testified in a bankruptcy hearing that the vending company had no contracts, no accounts receivable, and had not sold equipment or contracts within the previous 12 months, when in fact, the company had sold numerous vending machines and accounts and at the time of bankruptcy was receiving undisclosed payments for the sold accounts and machines. This investigation was initiated based on a referral from the financial institution.

Virginia Man Sentenced for Wire Fraud. The former president of a defunct soap making corporation located in Woodbridge, Virginia, was sentenced on April 29, 2003, to 16 months incarceration and directed to pay \$178,269 in restitution. On January 30, 2003, he pled guilty to one count of **wire fraud** in connection with a \$290,000 SBA-guaranteed loan. As part of his plea agreement, he agreed to the entry of a Restitution Order for the full amount owed to SBA and the lender. In December 1995, he traveled to Germany where he contracted to purchase a used soap-making machine for approximately \$186,210. On February 28, 1997, he submitted a loan application to obtain an SBA-guaranteed loan. On this form he falsely stated his date of birth, Social Security number, and criminal history. In addition, he falsely certified that the soap-making machine, which was collateral for the loan, had a value of \$515,295, when the actual value was substantially less. The defendant defaulted on the loan after making five payments. SBA suffered a loss of \$126,243 and the lender suffered a loss of \$52,026. OIG conducted this investigation based on a referral from the Virginia District Office.

Entrepreneurial Development Programs

OIG Issues Audit Report on Administrative Oversight of Operations of TEP Consulting, Inc. OIG issued an audit report on TEP Consulting, Inc., on April 2, 2003. The audit objective was to determine if the Office of Veterans Business Development (OVBD) effectively monitored TEP's compliance with the requirements of the SBA Cooperative Agreement. The audit covered administrative oversight of TEP's operations from September 1999 to June 2002. The auditors found that OVBD did not address TEP's possible noncompliance with cooperative agreement terms and conditions with TEP as they arose. This was due to a lack of expertise and training by OVBD staff and OVBD's overly cautious approach in notifying TEP of noncompliance issues. As a result, noncompliance issues were not corrected and Federal funds may not have been used effectively and efficiently.

OIG made recommendations to the Associate Administrator for OVBD to: (1) ensure that all deviations from the terms of the cooperative agreement are immediately communicated to TEP and rectified in a timely manner; and (2) develop and implement a plan of training to ensure that OVBD staff can effectively administer cooperative agreements such as the one with TEP. We received oral comments from OVBD officials and they agreed with the finding and recommendations.

As a result of the first recommendation made in the audit report, OVBD opted not to exercise the option year on the cooperative agreement and ultimately terminated the agreement.

OIG Issues Audit Report on Aspects of the Service Corps of Retired Executives (SCORE) Program. OIG issued an audit report on selected aspects of the SCORE Program on April 11, 2003. The objectives of the audit were to:

(1) assess controls put in place by management to ensure appropriate use of Federal funds; (2) review SBA's role in monitoring the financial and performance aspects of the grant award; (3) determine the scope and extent of SCORE's independent auditor's testing relative to its single audit; and (4) assess SCORE's FY 2002 proposed salaries for its three highest paid positions to determine if the proposed salaries were allowable and reasonable. The audit found that National Score Office (NSO) had an internal control structure in place to ensure appropriate use of Federal funds, except that NSO did not: (1) report program income earned by its chapters on SBA Form 269, "Financial Status Report," as required by the terms and conditions of the Notice of Award; and (2) include its chapters' financial activities in its financial statements in accordance with financial accounting standards. Additionally, the audit found that SBA's monitoring of the performance and

financial aspects of the award should be strengthened. The audit did not determine whether the established salary levels for the three highest paid salaried positions for FY 2002 were allowable and reasonable because the auditors concluded that SBA does not have express legislative authority to provide funding to SCORE for its paid positions.

As a result, OIG made recommendations to the Associate Administrator for the Office of Business and Community Initiatives (AA/OBCI) and the Assistant Administrator for Administration to address the deficiencies. The AA/OBCI generally concurred with the recommendations and the Director of the Office of Procurement and Grants Management stated that the Office of Administration had no comments. Office of Administration actions to address the finding and recommendation addressed to them will be evaluated during the audit resolution process.

Agency Management

OIG Issues Management Letter. As a result of SBA's FY 2002 financial statement audit, OIG's independent accountant, Cotton & Company LLP (Cotton), discovered certain non-reportable conditions that were communicated to SBA management in a management letter. The issues related to: (1) fund balance with Treasury differences; (2) foreclosed property records and valuations; (3) allotment detail; (4) administrative undelivered orders; (5) administrative costs; (6) sampling for erroneous payments; (7) intra-governmental reconciliations; (8) Federal Managers Financial Integrity Act reporting; (9) alignment of strategic goals with the Statement of Net Cost; (10) transactional detail for prior-year obligations; (11) fund control over administrative costs; (12) the general ledger account for loan sales; and (13) cash flow modeling. As a result, the auditors made recommendations to SBA's Chief Financial Officer (CFO) and Administrator to address the deficiencies. SBA management generally concurred with the recommendations with certain exceptions.

The activity Update is produced by SBA/OIG,
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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 such documents please contact:

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