# Office of Inspector General

**July through September 2016**

**BUSINESS LOANS**

On July 6, 2016, a Chicago-area entrepreneur pled guilty to financial institution fraud and sales tax evasion in an Illinois county circuit court. He had been indicted in connection with schemes to defraud the U.S. Small Business Administration (SBA), a participating bank, the Illinois Department of Commerce and Economic Development, and the Illinois Department of Revenue. The schemes involved commercial financing and retail sales tax for his two theaters.

The investigation revealed that, to obtain approval for $4.86 million in SBA refinancing for his failing businesses, the man directed his accounting manager to prepare false financial statements, alter profit and loss statements, and prepare bogus tax returns portraying a profitable business. Specifically, the entrepreneur grossly inflated 2009 through 2012 sales income figures by $50,000 each month. He also submitted the false documents to a lender service provider and a financial institution to support his loan applications.

A concurrent investigation by the Illinois Department of Revenue revealed sales tax evasion schemes at the theaters. The businesses together failed to pay at least $1.3 million in collected sales tax. Both businesses defaulted on their mortgages and filed for bankruptcy. This is a joint investigation with the Illinois State Department of Revenue, Bureau of Criminal Investigations, and Attorney General's Office.

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On July 18, 2016, the former owner of a California sushi bar and grill was sentenced in Federal court to 3 years of supervised release and was ordered to pay $992,582 in restitution, with SBA receiving $675,211 and the Federal Deposit Insurance Corporation (FDIC) (the receiver for the original lender) receiving $317,371. The man previously had pled guilty to bank bribery. He had been the owner of several small businesses in the San Diego area, including the sushi bar and a now-defunct supermarket.

In 2006, the sushi bar had been approved for a $250,000 SBA guaranteed loan. In 2008, the man was approved for a $1.8 million SBA guaranteed loan for the supermarket. In 2009, he defaulted on the supermarket loan, causing approximately $1.8 million in losses. In 2010, the bank failed and was taken over by the FDIC. The investigation found that the man gave cash to a bank employee in order to influence the funding of the two loans. He also conspired with an associate to submit several fabricated Internal Revenue Service (IRS) and State of California tax documents that falsely stated that outstanding business taxes had been paid. The fraudulent tax documents induced the SBA lender to approve the supermarket loan.

This investigation was worked jointly with the Treasury Inspector General for Tax Administration (TIGTA), Federal Bureau of Investigation (FBI), Federal Housing Finance Agency (FHFA) Office of Inspector General (OIG), and FDIC OIG.

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On July 26, 2016, the former executive vice president of a Missouri bank was sentenced in Federal court to 3 years imprisonment and 3 years of supervised release. He was also ordered to pay $4,223,917 in restitution.

The former executive had previously pled guilty to conspiracy to defraud the United States in connection with a complex commercial loan fraud scheme in which 16 others were also charged. The individuals were initially charged via a 185-count indictment for a bank fraud scheme that took advantage of SBA guaranteed loans. As part of the scheme, a number of SBA loans were fraudulently obtained by businesses ineligible to receive them. Accordingly, the co-conspirators concealed past due loan payments of distressed borrowers, made loans to nominee borrowers, created false entries in bank records, structured loans to avoid the bank board of directors' scrutiny, and concealed unrecorded letters of credit. They also utilized SBA loan proceeds for personal use, misapplied loan proceeds, prepared fraudulent SBA loan applications, and paid and accepted bribe money to secure loans.

While on pre-trial release related to the above charges, the former executive engaged in a check fraud scheme and was charged with possessing and uttering a forged security as part of another scheme to defraud the Government. Consequently, he and another individual each pled guilty for their role in providing false information to the U.S. Department of Housing and Urban Development (HUD) and Federal Housing Administration (FHA) in order to obtain a $18,219,400 loan for the operation and maintenance of a Missouri apartment complex. The former executive is the last of the 17 co-conspirators to be sentenced for the commercial fraud scheme. This investigation is being conducted jointly with the FBI and HUD OIG.

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On July 26, 2016, a New Jersey certified public accountant pled guilty in Federal court in the Eastern District of New York to aiding and assisting in the preparation of false tax returns. He had prepared false tax returns on behalf of businesses partially and fully owned by another man.

The businessman had engaged in bank fraud involving both SBA and non-SBA loans, beginning in approximately 2003. He falsely minimized his ownership interests in numerous businesses, thus allowing him and his partners to obtain more SBA and other loans than they would have otherwise qualified for. The businessman also operated a Ponzi scheme, whereby he would use the proceeds of one business loan to finance the start-up of another business. The businessman pled guilty in 2014 and is awaiting sentencing. The investigation is being jointly conducted with the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) and IRS Criminal Investigation (CI).

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On August 12, 2016, a Minnesota soybean exporter pled guilty in Federal court to making false statements in connection with a bank fraud scheme. The investigation revealed that the man, on behalf of a grain company, applied for and received a line of credit through the bank between 2011 and 2013. The credit line was guaranteed by SBA under the Export Working Capital Program (EWCP), with the man serving as a personal guarantor. He renewed and increased the line of credit with the bank multiple times, with each increase requiring him to provide truthful information regarding his financial condition, loan purpose, and background, including any liens and judgments against him. During his annual renewal of the company's line of credit, the man concealed from the bank and SBA that he had been served with a complaint and summons in 2008 for a civil lawsuit alleging breach of contract and business fraud. Moreover, after losing a 2011 trial resulting from this civil lawsuit, Wilcox concealed from the bank and SBA a $98,519 judgment entered against him in 2012 by a Minnesota county court.

The investigation also showed that the man wrote $407,247 in checks from the grain company's EWCP line of credit to his associated soybean processing business in order to pay that firm's construction costs. He knew that he was not permitted to transfer proceeds from his export line of credit to pay the expenses of another company unrelated to soybean exporting and that doing so was a misapplication of EWCP loan proceeds.

His actions resulted in the bank and SBA suffering $1,497,305 in losses. This is an ongoing joint investigation with the FBI.

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On August 15, 2016, a bank agreed to pay the United States $9.5 million to settle claims under the False Claims Act in connection with the issuance of SBA-guaranteed loans. The bank entered into the settlement agreement through the U.S. Department of Justice on behalf of SBA after having been found civilly liable for not adhering to SBA Preferred Lenders Program (PLP) requirements.

The bank had approved 74 SBA loans that were brokered by an investment firm through its principals. Beginning in 2006, certain investment firm loans went into default. The bank submitted guaranty claims to SBA for payment of many of these loans. SBA approved the claims for 24 loans and paid the bank the SBA-guaranteed portion of the unpaid balances at the time of default, minus any recovery from the liquidation of business assets.

The U.S. Attorney's Office for the District of Maryland subsequently prosecuted a major principal and others associated with the investment firm for conspiring to commit bank fraud. The scheme was designed to fraudulently obtain SBA-guaranteed business loans, with resulting losses of over $100 million. The main principal and other defendants admitted that they created and submitted false and fraudulent documents to secure the bank's loan approvals. For example, he and others used computer software programs to alter bank statements and created false management resumes, profit and loss figures, gift letters, and other documents. The bank in turn approved the loans based on this documentation. The main principal and five other defendants were convicted for their roles in the scheme and sentenced to Federal prison.

The United States contended that it had civil claims against the bank because it failed to adhere to PLP lender requirements. These requirements include demanding adequate bank and Internal Revenue Service tax records from the borrowers, ensuring that borrowers had the ability to repay the loans, and applying prudent lending standards. Moreover, the bank had sought payment on SBA guarantees even though the bank should have known that SBA requirements for recovery on the guarantees were not met. This investigation was worked jointly with the FBI.

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As part of its High-Risk 7(a) Loan Review Program, on August 16, 2016, the Office of Inspector General (OIG) issued a report, Report 16-19, which provides the Small Business Administration (SBA) with early notification of issues identified as part of our review. We identified material lender non-compliance with SBA's loan origination and closing requirements. Specifically, the lender neither ensured SBA loan proceeds were used for an eligible purpose nor assessed the borrower's repayment ability and size in accordance with SBA's requirements. As a result, a recovery from the lender for SBA's guarantee payment of $850,791 is appropriate to cure the lender's material deficiencies on this loan. The Agency agreed with the recommendation to recover funds from the lender.

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On August 22, 2016, the former vice president and SBA manager of a California bank was sentenced in Federal court to 3 years of supervised release with 12 months of home detention. She was also ordered to pay $973,789 in restitution to SBA and $482,283 in restitution to the Federal Deposit Insurance Corporation (FDIC). The vice president previously pled guilty to conspiracy.

Although the vice president did not have direct authority to lend bank funds, she reviewed borrowers' applications and recommended that loans be approved and funds disbursed. She conspired with others to misapply bank funds in order to issue loans under favorable terms to unqualified or under-qualified borrowers. While personally enriching themselves, they knew the disbursements provided no benefit to the bank. Moreover, they supported the disbursement of bank funds by supplying or knowingly accepting false information in the borrowers' loan applications and overlooking negative aspects of the borrowers' creditworthiness. This was a joint investigation with the FBI, TIGTA, FDIC OIG, and FHFA OIG.

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On August 30, 2016, the former president of a Georgia bank company was debarred from participation in procurement and non-procurement activities throughout the executive branch of the Federal Government. The debarment action was brought by SBA and was precipitated after the man had pled guilty to conspiracy to commit bank fraud and conspiracy to commit major fraud against the United States. He admitted that, from 2005 through 2010, he committed bank fraud during his employment as the bank's president and chief executive officer. Moreover, he admitted conspiring with others to obtain money, funds, credits, assets, securities, and other property of the bank, while replacing non-performing loans with new Government guaranteed loans. This included a $1.5 million SBA-guaranteed loan to a home construction firm to make the bank appear financially stronger than it actually was. To save the failing bank, the president continued these illegal activities while the bank received assistance from the Troubled Asset Relief Program (TARP), a Government program for helping financial institutions during a financial crisis. His actions resulted in a $3,931,018 loss to SBA, the U.S. Department of Agriculture, and the FDIC.

The debarment prohibits the former bank president from representing borrowers of SBA loans and participants in other SBA programs. He also may not participate in, or represent a person participating in, covered procurement or nonprocurement transactions with the Federal government. This is a joint investigation with the FDIC, the SIGTARP, the FBI, the U.S. Department of Agriculture OIG, and the Tift County Sheriff's Office.

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On August 15, 2016, a California loan broker for a now-defunct bank was sentenced in Federal court to 3 years of supervised release with 10 months of home detention. She was also ordered to pay $82,185 in restitution to the Federal Deposit Insurance Corporation (FDIC). She had previously pled guilty to making false statements related to an investigation into bribes paid to the bank's vice president and SBA lending department manager.

As part of her guilty plea, the loan broker admitted paying cash bribes in return for the bank manager's assurance that loans for the business customers the broker referred would be approved and funded and that the broker's commissions would be paid. As part of her job, the broker helped her borrowers compile their loan application packages and submit them to the bank. In return for generating business, the bank paid her a commission or referral fee, which was calculated as a percentage of each loan referred. The broker collected tens of thousands of dollars from the bank. She "kicked back" a portion of the fees to the bank manager, in cash, every time she was paid. The broker admitted that, in 2006, the bank manager had asked her for such an arrangement.

In turn, the bank manager made sure that the broker's clients' loans were approved so that the broker could collect commissions, regardless of the loans' soundness and their benefit to the bank. In addition, the manager arranged to pay the broker a fraudulent $30,000 "commission" for a loan she had no part in brokering. The broker generated a fake invoice, pretending that she had earned the commission.

She also admitted lying to law enforcement agents by concealing these bribe payments and hiding her relationship with the bank manager. She falsely told Federal agents that she never saw the manager accept money in exchange for loans. Moreover, even though the two women traded several phone calls and text messages and had a

June 2014 sit-down meeting, the broker falsely reported to Federal agents in September 2014 that she had not spoken to or seen the manager since before she learned about the investigation. In her plea agreement, the broker acknowledged that her false statements significantly impeded the investigation of the bank manager.

This was a joint investigation with the FBI, TIGTA, FDIC OIG, and FHFA OIG.

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On September 28, 2016, a former Illinois commercial real estate appraiser and president of an appraisal company was sentenced in Federal court to 30 months of incarceration and 1 year of supervised release. He also was ordered to pay $553,367 in restitution.

The man had previously pled guilty to evading income tax. He had been one of seven Chicago-area individuals indicted as part of this ongoing investigation. The appraiser also was the president, sole owner, and sole shareholder of a second valuation firm. He maintained a bank account in that firm's name.

As the sole owner of the first company, the appraiser was required to report all ordinary income or loss from that company on his individual income tax return. In 2008, the first company had gross receipts exceeding $1 million. He diverted more than $550,000 of that company's gross receipts to his own use by directing its employees to issue checks payable to the second firm or to him personally. He then deposited, or caused to be deposited, the checks into a separate bank account. The embezzled funds were then used for his personal use.

His tax evasion activities were discovered during a loan fraud investigation at a different bank. A former SBA market president at that bank used the appraiser's services for every fraudulent SBA loan that he approved. Over the past 10 years, taking into account this and other loan fraud investigations, the appraiser completed appraisals for hundreds of different businesses associated with fraudulent SBA-guaranteed loans. This investigation is being conducted jointly with the FDIC OIG, IRS CI, and the FBI.

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On September 30, 2016, OIG issued Management Advisory 16-23, *Audit of SBA's 504 Loan Liquidation Process*. This management advisory presents the results of our audit of the Small Business Administration's 504 loan liquidation process. Based on our results, we believe management and monitoring of the 504 liquidation portfolio at the Commercial Loan Servicing Centers (CLSC) during FYs 2015 and 2016 was effective. Additionally, SBA CLSCs generally maximized recovery when liquidating the 504 loans we reviewed. While SBA had established effective policies and procedures and had experienced staff managing its current 504 loan liquidation operations, we identified opportunities to improve SBA's internal controls. Specifically, we determined that one CLSC had not developed a formal training plan for staff in accordance with established goals and procedures. We also determined that the internal policies and procedures for liquidating 504 loans were unique to and applied inconsistently at the centers. In addition, components of the information systems used by each center were developed independently and were not utilized uniformly. Without consistent implementation and application of policies and procedures over the 504 loan liquidation process, the CLSCs' effectiveness in liquidating 504 loans could result in loss to the Agency. Further, in the event of significant turnover or workload fluctuation at a given center, differences in operations could impact the Agency's ability to effectively reallocate resources to meet demand. OIG recommended two actions that will help improve SBA's internal controls over servicing and liquidating 504 loans. The Agency agreed with OIG's findings and recommendations.

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On September 30, 2016, OIG issued Report 16-22, The OIG High Risk 7(a) Loan Review Program Recommends $3.2 Million in Recoveries. This report presents the results of our ongoing High Risk 7(a) Loan Review Program from April 2015 to September 2016 and an overall summary of our work to date.

OIG's review of eight early-defaulted loans identified material lender origination and closing deficiencies that justified denial of the guaranty for three loans totaling $3.2 million. To facilitate SBA's timely review and recovery of these payments, we formally issued separate reports on each loan that included detailed descriptions of the identified material deficiencies. We also identified suspicious activity on two purchased loans totaling $1.4 million, resulting in formal referrals to our Investigations Division.

To date, four loans that had material lender deficiencies or indications of suspicious activity financed change of ownership transactions. In our judgment, change of ownership transactions continue to be an area of high risk for SBA. Furthermore, four loans we formally reported on or referred to our Investigations Division were included in either SBA's FY 2014 or FY 2015 reviews for improper payments. SBA did not identify or report the improper payments totaling $4.5 million associated with these loans.

OIG recommended in previous management advisory memorandums that SBA require the lenders to bring the three loans into compliance or seek recovery of approximately $3.2 million. SBA agreed with the recommendations and is working with the lenders. In this report, we recommended that SBA evaluate the time National Guaranty Purchase Center (NGPC) loan specialists have to review complex early-defaulted loans involving change of ownership transactions. SBA agreed with the recommendation and will conduct the evaluation.

**DISASTER LOANS**

On July 22, 2016, SBA realized a $300,000 cost avoidance based on information provided by the OIG. SBA declined a New York man's disaster home loan application after the OIG disclosed that the property damaged by Hurricane Sandy was not his primary residence. SBA previously approved a $250,300 loan under the original Hurricane Sandy legislation, in which $14,000 was disbursed. The man repaid the $14,000 to SBA and cancelled the remaining $236,300 balance. He re-applied under subsequent Hurricane Sandy legislation in June 2016. The new loan had been scheduled for disbursement in July 2016. This ongoing investigation is being conducted jointly with the U.S. Department of Homeland Security (DHS) OIG and HUD OIG.

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On July 29, 2016, a New Jersey woman was sentenced in State court to 12 months of probation and was ordered to pay $90,733 in restitution, including $37,036 owed to SBA. She and her husband had pled guilty to theft by deception in connection with filing false applications following Hurricane Sandy. He is jointly responsible for the $37,036 in SBA restitution.

The investigation disclosed that the married couple falsely claimed that their storm-damaged property in one New Jersey city was their primary residence during Hurricane Sandy. In reality, their primary residence was in another city, and the damaged property was a summer home. They applied and were approved for a $64,000 SBA disaster loan but ultimately, accepted and received just $40,000 in loan proceeds, of which the current balance is $37,036. The wife filed other applications by herself. Consequently, she received $28,875 in Federal Emergency Management Agency rental assistance. She also received state grants of $12,698 under the Homeowner Resettlement Program and $12,123 under the Reconstruction, Rehabilitation, Elevation and Mitigation Program. This investigation was conducted jointly with a task force comprised of the New Jersey Department of Community Affairs, DHS OIG, and HUD OIG, in conjunction with the New Jersey Office of the Attorney General.

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On August 12, 2016, the SBA Office of Credit Risk Management debarred a New Jersey woman for 3 years from participating in Federal financial and non-financial assistance programs, representing participants in such programs, and participating in Federal procurement transactions. SBA's decision was based on information previously provided by the OIG. This included a judgment and conviction against her in State court for theft by deception.

The woman had applied for and received various disaster grants and loans related to Hurricane Sandy. The investigation disclosed that she had claimed a storm-damaged New Jersey house as her primary residence, when it was a vacation home. Moreover, she had been living in New York State during the hurricane. As a result of fraudulent disaster applications, the woman received $40,000 in SBA disaster loan proceeds and $143,051 in New Jersey grants under the Reconstruction, Rehabilitation, Elevation and Mitigation grant program. This case was investigated jointly by a Hurricane Sandy task force comprised of SBA OIG, HUD OIG, DHS, the New Jersey Division of Criminal Justice, and the New Jersey State Department of Community Affairs in conjunction with the New Jersey Office of the Attorney General.

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On August 15, 2016 OIG published Audit Report 16-18, *Early-Defaulted Hurricane Sandy Disaster Loans*, which presents the results of our audit of the Small Business Administration's (SBA) performance in mitigating the risks of Hurricane Sandy disaster loans from defaulting early (within 18 months of disbursement). SBA's Office of Disaster Assistance (ODA) provides financial assistance in the form of low-interest Government loans to help homeowners, renters, and businesses throughout the United States affected by natural disasters. Hurricane Sandy, which struck the East Coast on October 29, 2012, caused approximately $67 billion in damage in the United States. It was the nation's most costly storm since Hurricane Katrina, which caused $128 billion in damage. As of November 2013, SBA had approved and disbursed 19,295 loans, totaling approximately $758 million. As of April 2015, 501 of these loans had defaulted early. We selected and reviewed a random, statistically valid sample of 21 early-defaulted Hurricane Sandy loans to determine whether the borrower was eligible, had satisfactory credit history, and had repayment ability.

We found that the overall early default rate on Hurricane Sandy loans was relatively low when compared to loans made for other disasters. However, we found that in 17 of the 21 loans we reviewed, ODA approved loans without verifying borrowers' eligibility, or approved loans to borrowers who generally lacked creditworthiness or repayment ability. Due to the significance of the errors in the areas of creditworthiness and repayment ability, we projected our results to the universe of early-defaulted loans and estimated that at least 361 of the 501 early-defaulted loans, totaling $4.3 million, were not approved in accordance with SBA and/or Federal requirements. Borrower creditworthiness was the most prevalent area of concern we noted on the early-defaulted loans. In the majority of loans we reviewed, SBA approved loans to borrowers with unsatisfactory credit histories. Additionally, we determined that while ODA routinely analyzed disaster loan portfolio risks, improvements could be made to reduce the rate of early defaults. OIG made five recommendations to improve SBA's performance in mitigating the risk of disaster loans from defaulting early. These recommendations include clarifying guidance pertaining to borrower creditworthiness; providing training to employees related to our findings in the areas of creditworthiness, repayment ability, and eligibility; and improving existing portfolio risk analyses.

**GOVERNMENT CONTRACTING**

On June 24, 2016, SBA entered into an administrative agreement with three companies and two individuals that prevents their participation in Federal procurement transactions for one year. As part of the agreement, the parties will implement a business ethics program and a code of ethics for all their employees. SBA's decision was based on information previously provided by the OIG, which included a settlement agreement in a civil action brought against the parties for violating the False Claims Act. The parties had engaged in a fraudulent certification of a service-disabled veteran-owned small business in order to obtain contracts from the U.S. Government, including the Department of Veterans Affairs, for various construction projects. The administrative agreement is intended to provide assurances to the Government that all parties are responsible. SBA will take no further action as long as the terms and conditions of the agreement are met.

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On July 6, 2016, five California companies headquartered in the same building entered into a settlement agreement with the U.S. Government and two qui tam relators. In a qui tam complaint, a private citizen (the relator) can sue on behalf of the United States and share in any recovery. The settlement agreement resolved the relators' qui tam action against the five companies pursuant to the False Claims Act. Per the agreement, the five companies will pay $5,801,694 to the United States and an additional $115,000 to the relators for attorney's fees.

The relators alleged that between 2010 and 2014, one of the companies falsely represented and certified it was a small business concern in order to obtain Federal small business set-aside government contracts. They alleged the firm did not quality as a small business, per SBA regulations, due to its affiliation with two of the other firms, both of which are large companies. Nonetheless, the firm claiming to be a small business submitted bids for and obtained Federal small business set-aside contracts. The investigation confirmed the allegations.

The California companies neither admitted liability nor concurred with the allegations. However, all parties did agree to the terms of the settlement agreement. This case was initiated based on the qui tam lawsuit. This was a joint investigation with the General Services Administration OIG.

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On August 11, 2016, a Texas man was sentenced in Federal court to 69 months of imprisonment, to be followed by 3 years of supervised release. In addition, the man was ordered to forfeit $1,270,304. A jury previously found him guilty of theft of Government money or property, as well as aggravated identity theft.

The man had created a company and had been awarded contracts set aside for service-disabled veteran-owned small businesses. However, he was not a veteran and had used the identity of his father, who was a service-disabled veteran, to qualify for set-aside contracts that he otherwise would not be entitled to. The father was in no way affiliated with company.

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On August 4, 2016, a man was debarred from Federal government contracting by the U.S. Department of the Navy. He previously had been sentenced in Federal court to 36 months of supervised probation, with a 6-month stay at a residential facility, and had been ordered to pay $857,097 in restitution for conspiracy to commit wire fraud and tax fraud. The man intentionally had made material misrepresentations to the U.S. Government by falsely representing himself as the president and owner of two Maryland technology firms. A husband and wife were in fact the controlling corporate officers and majority shareholders of the companies.

The two firms had been awarded millions of dollars in Federal contracts set aside for small businesses and service -disabled veteran-owned small businesses. Competitors had protested the companies' eligibility several times

based on affiliation issues and size determination matters. Each time SBA had found the firms to be small businesses. However, the two companies had submitted false documents to SBA in order to be awarded contracts.
This investigation was conducted jointly with the IRS, Defense Criminal Investigative Service (DCIS), Department of Labor OIG, and Air Force Office of Special Investigations.

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On August 8 and August 17, 2016, the owner of a construction company pled guilty in Federal court on Guam to different counts of conspiracy to commit visa fraud. On August 9, his sister, who was also the firm's vice president, pled guilty to conspiracy to commit money laundering.

Case agents previously served a seizure warrant to a bank for $1,875,407. The bank immediately froze the funds and issued an official bank check payable to the U.S. Department of the Treasury. Immediately following the bank seizure, the construction company owner was located at his firm and arrested.

The investigation revealed the two individuals had misused the H-2B visa worker program while working on Section 8(a) set-aside contracts awarded to the construction company. It also found that the man had a prior criminal history associated with a similar 1998 visa fraud violation that he failed to disclose to SBA in his 8(a) application and his firm's annual updates. His prior criminal history and misuse of the H-2B visa program are violations of the 8(a) program's entry and continued eligibility requirements related to good character. Because of the non-disclosures, the construction company was granted 8(a) status and illicitly awarded 8(a) set-aside contracts in excess of $20 million.

Due to its proximity of the individuals, IRS CI is leading this investigation. SBA OIG and Homeland Security Investigations will jointly monitor the investigation to completion.

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On August 23, 2016, a Colorado man pled guilty in the U.S. District Court for the District of Columbia to conspiracy to commit wire fraud. He is a former owner and chief financial officer of a Colorado construction corporation.

The corporation and others conspired with two companies that were eligible to receive Federal government contracts set aside for small disadvantaged businesses. The understanding was that the corporation would illegally perform all of the work. In so doing, the corporation was able to win 27 government contracts worth over $70 million from 2008 to 2011. The scope and duration of the scheme resulted in a significant number of lost opportunities to legitimate small and disadvantaged businesses. The man and others created agreements between the corporation and the two 8(a) companies that formalized the understanding that the corporation would perform all of the work on the 8(a) contracts while the 8(a) companies received a three percent pass -through fee. In one of these contracts, a U.S. General Services Administration (GSA) contracting officer filed a protest with SBA, claiming that one of the companies was other than a small business because of its relationship with the corporation. SBA conducted a size determination to determine whether the corporation's bid on behalf of one of the companies violated SBA rules and regulations. The former owner and others took steps to corruptly influence, impede, and obstruct the SBA size determination protest by willfully making false statements to SBA about the extent and nature of the relationship between the corporation and one of the companies.

This case is being jointly investigated with the FBI, DCIS, and GSA OIG.

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On September 15, 2016, the U.S. Army debarred the owner and former president of a Colorado information technology firm from conducting business or contracting with the Federal government for 5 years. The debarment was based on his 2014 indictment in Federal court for making false statements to SBA, conspiracy, and filing false tax returns.

The man had directed his accountant and controller in the concealment of millions of dollars in assets, including a Vail, CO, condominium. He also diverted millions of dollars in unreported income, mostly through overseas accounts. This information was omitted from SBA annual updates and financial statements. Thus, the owner was able to maintain his firm's certification as a Section 8(a) disadvantaged business.

In addition, he concealed the assets and income from the IRS by filing false tax returns. His misrepresentations led to the wrongful award of over $17 million in 8(a) set-aside contracts to his firm from 2006 to 2010. In 2015, he was sentenced to 6 months in prison and 1,000 hours of community service. He also was ordered to pay $1,171,179 in restitution and a $250,000 fine after having pled guilty to conspiring to commit offenses against the United States, SBA, and IRS. This investigation was worked jointly with the DCIS, IRS CI, GSA OIG, and U.S. Army Criminal Investigation Command. This matter was referred by the GSA OIG.

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On September 27, 2016, the co-owner of a Massachusetts construction firm was sentenced in Federal court to 30 months in prison and 1 year of supervised release. He also was ordered to pay a $1 million fine. In addition, a forfeiture hearing is forthcoming. A jury had previously found him guilty of conspiracy to defraud the United States and wire fraud.

The investigation disclosed that, between 2006 and 2010, the man had made false statements to the Department of the Army, GSA, Department of the Navy, and Department of Veterans Affairs (VA) regarding his firm's qualifications in order to receive service-disabled veteran -owned small business set-aside contracts. The investigation was conducted jointly with the U.S. Army Criminal Investigation Command, GSA OIG, NCIS, and VA OIG.

**AGENCY MANAGEMENT**

On August 11, 2016, the Office of Inspector General issued KPMG's report, *Fiscal Year 2016 Report of the U.S. Small Business Administration (SBA) Pursuant to The Cybersecurity Act of 2015, Section 406, Federal Computer Security*. OIG contracted with the independent certified public accounting firm KPMG to evaluate whether SBA designed and implemented its internal controls over cybersecurity logical access and information security management in accordance with Section 406 of the Cybersecurity Information Sharing Act of 2015 (the Cybersecurity Act). We selected a subset of personally-identifiable information development and production systems for KPMG's review and evaluation. The attached independent auditor's report found that the Agency did not meet Federal standards relating to Section 406 of the Cybersecurity Act. The Office of the Chief Information officer agreed with evaluation findings and conclusions. Related recommendations will be issued in conjunction with our annual Federal Information Security Management Act (FISMA) assessment.

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As part of its ongoing review of the Small Business Administration's (SBA) pay setting practices, the Office of Inspector General (OIG) issued Report 16-20 on August 22, 22, 2016, which provides SBA with early notification of issues identified as part of our review. We identified that Executive Resources set initial pay higher than allowed for 4 out of 10 Senior Executive Service (SES) employees we reviewed. Additionally, for one political SES hired in March 2015, Executive Resources set the initial pay based on the 2015 SES pay table instead of 2013, which resulted in an overpayment of $969. Furthermore, because SBA lost its SES certification on August 25, 2015, the pay levels for newly appointed political SESs hired after that date must be based on 2013 rates of basic pay for agencies without a certified SES performance appraisal system. Nevertheless, Executive Resources set the initial pay for three political SESs above level III of the 2013 executive pay schedule after SBA lost its SES certification, which amounted to overpayments totaling $6,704. In total, the four SES appointees received overpayments totaling $7,673. Accordingly, this advisory contains three recommendations to strengthen internal controls over pay setting practices. SBA management agreed to implement these recommendations, including recovering the overpayments.

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On August 23, 2016, the U.S. Small Business Administration (SBA) Office of Inspector General (OIG) published its evaluation report 16-21: *SBA's 2015 and 2016 Cash Gifts*. The Consolidated Appropriations Act, 2016 (the Act) gives SBA the authority to accept gifts to carry out its mission. Employees may solicit and accept gifts on behalf of SBA after proper approvals, including a conflict of interest determination by SBA's Office of General Counsel. The Consolidated Appropriations Act provides that any gift, devise, or bequest of cash accepted by the Administrator shall be held in a separate account and shall be subject to semiannual audits by the Inspector General who shall report his or her findings to Congress.

Our evaluation found that SBA generally complied with the Act regarding the solicitation, acceptance, holding, and utilization of cash gifts. We determined that SBA's Office of Communications and Public Liaison obtained proper approval from the Office of General Counsel for the 2014 National Small Business Week. However, of the 14 entities that cosponsored the 2014 National Small Business Week, 3 were not properly vetted through SBA program offices to ensure no business relationships existed that would cause a conflict of interest. Also, SBA's Office of General Counsel did not confirm whether a conflict of interest existed between SBA and two of those entities. We also determined that SBA's Office of Communications and Public Liaison did not distribute excess cash contributions in accordance with SBA policy. Specifically, the fiscal agent retained custody of $75,000 instead of distributing it in accordance with SBA policy. In addition, SBA did not always use gift funds for allowable expenses in accordance with SBA regulations and policy.

We made four recommendations that the Agency agreed to implement.

## Office of Inspector General
***Peggy E. Gustafson***
**Inspector General**

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To promote integrity, economy, and efficiency,
we encourage you to report suspected instances of
fraud, waste, abuse, or mismanagement
in any SBA program to the OIG Hotline* at
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**Or call the OIG Hotline toll-free, at (800) 767-0385**

**In accordance with Sections 7 and 8L(b)(2)(B) of the Inspector General's Act, confidentiality of a complainant's personally identifying information is mandatory, absent express consent by the complainant authorizing the release of such information.*

We welcome your comments concerning this update or other OIG publications.

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