Office of Inspector General
U.S. Small Business Administration

September/October 2010 Update

Business Loan Programs

Review of America's Recovery Capital (ARC) Loan Program. On September 22, 2010, the OIG issued a report on a review of SBA's implementation of the ARC loan program. The OIG identified 38 lender-approved ARC loans, valued at $1.2 million, made to what appear to be affiliated companies that were not approved by SBA, as required by the ARC loan program procedural guide. These were identified as potentially affiliated loans due to common social security numbers, common addresses, and familial relationships between the business owners. Also, two of the loans were made to apartment buildings, which were not eligible for SBA financial assistance. The OIG recommended that SBA review each of the 38 loans to determine if they were made to eligible companies, cancel the loan guaranties for any loans determined to be made to ineligible companies, and collect any associated interest paid to the lenders. The OIG also recommended that SBA conduct additional reviews to identify other ARC loans made to affiliated companies that were inappropriately approved by lenders.

Material Deficiencies in Early-Defaulted and Early-Problem Recovery Act Loans. On September 24, 2010, the OIG issued a report on a review of 39 7(a) Recovery Act loans that experienced early default or early borrower repayment difficulties. The OIG identified material deficiencies in 82 percent of the loans reviewed, resulting in the disbursement of approximately $5 million to borrowers who could not repay or were ineligible for the loans. Twenty of the loans were made by two lenders who used credit scoring matrices that did not comply with SBA requirements. One of the lenders no longer makes SBA loans while the other lender, who is still active, was responsible for 18 of the 20 loans. Another 12 loans had repayment ability, equity injection, and/or eligibility deficiencies. The OIG believes that these material deficiencies caused or contributed to the early loan defaults or loan problems. As of June 2010, SBA had purchased its guaranteed share on 25 of the 32 loans, resulting losses of $375,259.

In addition to the material deficiencies identified above, the OIG found that that lenders made disbursements without (1) required immigration certifications, (2) restricted use certifications, and/or (3) Forms 159, Fee Disclosure Form and Compensation Agreement, on 28 Recovery Act loans, including 24 of the loans identified above with material deficiencies. Finally, the OIG identified suspicious activity in 10 loans that were referred to the OIG's Investigations Division for further review.

The OIG recommended that SBA: (1) reexamine the credit scoring matrix used by a lender that made 18 of the 32 loans with material deficiencies to ensure it complies with SBA requirements; (2) implement a process for providing feedback to SBA employees and lenders when deficiencies are identified; (3) require lenders to bring the 25 purchased loans with material deficiencies into compliance or recover the $375,259 in SBA guaranties paid; (4) obtain the certification for the loan missing only an immigration certification, or recover $3,248; and (5) flag the other loans that have not yet been purchased to ensure the loan deficiencies are properly addressed at the time of guaranty purchase review.

Chicago Entrepreneur Indicted. On August 18, 2010, a commercial loan officer/Chicago-area entrepreneur was indicted on two counts of operating a continuing financial crimes enterprise, three counts of financial institution fraud, and three counts of loan fraud, in connection with multiple attempts to defraud the SBA, an SBA Certified Development Company (CDC), and four participating banks. The indictment alleges that, in order to profit from the sale of his failing business, he directed a Chicago-area commercial loan broker to prepare false corporate financial statements portraying his business as profitable. He then submitted the bogus financial statements to the CDC and four SBA lenders. The inflated financial statements induced the lenders to approve their respective loan packages and to make loan commitments totaling $6.18 million. Any of these fraudulent loans would have exposed the lender and SBA to increased loss potential; however, each of the loan commitments was canceled during the investigation. The SBA OIG is conducting this investigation jointly with Federal Deposit Insurance Corporation OIG.

Washington Businessman and Attorney Plead Guilty. On September 21, 2010, a Vancouver, Washington businessman pled guilty to one count of making false statements to the SBA and aiding and abetting. As the business broker handling the sale of a disaster restoration company, he assisted a buyer in obtaining a $1,999,800 loan from an SBA lender. In addition, on October 20, 2010, the attorney for the seller of the disaster restoration company pled guilty to the same charges. The investigation disclosed that both the broker and the attorney knowingly and willfully made, and aided and abetted the making of, false statements to the SBA by understating the true purchase price of the business by approximately $3 million; failing to disclose a $1 million promissory note; falsely representing the duration of the seller's employment contract and earn-out agreement; and structuring the closing to occur in two sessions in order to conceal the above described misrepresentations from the lender and the SBA. This case is being investigated the OIG jointly with the Internal Revenue Service, Criminal Investigation Division.

Texas Men Indicted. On September 24, 2010, a indictment charging two Texas businessmen with one count of conspiracy, two counts wire fraud, and two counts of mail fraud, was unsealed. The indictment also included a notice of forfeiture for property including, but not limited to, approximately $2,692,750. The indictment alleges that the men conspired to artificially inflate the value of a hotel in Houston, Texas. One of the men then used the artificially inflated price to obtain an SBA-guaranteed loan of $1,327,000 as part of the financing for the purchase of the motel. The OIG is conducting this investigation jointly with the Federal Bureau of Investigation (FBI).

Illinois Entrepreneur Sentenced. On October 12, 2010, a Springfield, Illinois entrepreneur was sentenced to 15 months in prison, 5 years supervised release, and restitution totaling $63,870.99. He previously pled guilty to submitting false information to a financial institution in connection with multiple schemes to defraud the SBA and two Springfield-area banks. He obtained SBA-guaranteed loans totaling $121,695 from the two banks to purchase Egyptian artifacts for two art-exhibition companies he created. The investigation revealed that he submitted false invoices and letters to both banks supporting purchases of collateral artifacts that were never completed. The investigation also showed that nearly all loan proceeds were wired or otherwise diverted to personal accounts at a third bank and were used to support a lavish lifestyle that included multiple trips to South America, a new home, a luxury automobile, and a Harley Davidson motorcycle. In addition, in an effort to be released from all liabilities connected to the loans, he forged letters on the banks' letterhead claiming he was a victim of identity theft and mailed the letters to the major credit bureaus. The OIG's investigation was conducted concurrent with FBI and Drug Enforcement Administration (DEA) investigations.

Former Real Estate Agent Pleads Guilty. On October 14, 2010, a former real estate agent in Springfield, Missouri, pled guilty to one count of making false statements for the purpose of influencing the SBA and aiding and abetting. The investigation revealed that he was approached by an individual who asked him to obtain a 90-day loan for that individual's internet wireless business. He received $7,500 for obtaining the loan. The remaining loan proceeds went to benefit other individuals and business entities. The OIG is conducting this investigation jointly with the FBI.

Maryland Restaurateur Convicted. On October 25, 2010, the vice president and an owner of a now defunct restaurant in Lusby, Maryland was found guilty in a jury trial of one count of conspiracy, one count of making false statements and aiding and abetting, and one count of making false statements to the SBA and aiding and abetting. He obtained an SBA-guaranteed loan in the amount of $417,000 to perform construction/renovation work for leased space and to purchase equipment and inventory for a new restaurant business. On his loan application, he certified the cost of the construction work to be

$295,000, even though he had already entered into an agreement with a construction company to do the work for $145,000. He also conspired with the construction company to falsely represent the total cost of the project.

Government Contracting and Business Development

Colorado District Office's Servicing of 8(a) Business Development Program Participants. On September 30, 2010, the OIG issued a report on the SBA Colorado District Office's servicing of 8(a) Business Development program participants. The review was initiated in response to a complaint alleging that actions taken by that office hurt small businesses and wasted government resources. The OIG found that, while many of the specific examples in the complaint were not substantiated, the Colorado District Office did not function as well as it should have to provide consistent and worthwhile assistance to some of the companies in its 8(a) portfolio. Specifically, it did not apply servicing procedures consistently and timely for three of eight firms reviewed. One firm should have been recommended for termination for non-compliance with the program's annual reporting requirements. Instead the district office accepted over $6.5 million in 8(a) procurements since May 2009 on the company's behalf. Another firm waited 10 months to obtain SBA approval of its mentor protégé agreement. A third firm was allowed to receive a sole-source contract when it was ineligible to do so. Additionally, 23 of 205 firms contacted expressed general dissatisfaction with the district office because Business Development Specialist's (BDS) were not assigned or accessible, requests for assistance were not met timely or at all, and the quality of assistance was poor. Participants also complained that access to the district office was restricted to only two days a week and by appointment only.

The OIG recommended that the Colorado District Office take steps to recommend termination of the firm identified as no longer being eligible for the 8(a) program, minimize or end restrictions on participant access to the district office, and ensure that all 8(a) firms are assigned a BDS. The OIG also recommended that SBA require the district office to use a Customer Relationship Management (CRM) system to track customer requests and monitor CRM status reports to ensure that requests are addressed timely. Finally, the OIG recommended that SBA determine the adequacy of training provided BDSs, take steps to address training shortfalls, annually administer a nationwide customer satisfaction survey and tie the survey results to District Director performance ratings, and determine whether district offices are appropriately staffed to provide for adequate servicing of 8(a) firms.

Business Owner Indicted. On September 1, 2010, the owner of an 8(a) certified design/remodeling business was charged with one count of conspiracy. She is alleged to have conspired to submit falsified information to the General Services Administration (GSA) in the course of obtaining an 8(a) contract with the Department of Homeland Security (DHS), Immigration and Customs Enforcement (ICE). As a result of the conspiracy, ICE suffered a loss of $389,738. The SBA OIG is conducting this investigation jointly with DHS ICE, the GSA OIG, and the Department of Justice (DOJ) Antitrust Division.

Government Contractor Sentenced. On September 15, 2010, a contractor at the National Archives and Records Administration (NARA) was sentenced to 15 months in prison followed by three years supervised release. He was also ordered to pay restitution of $958,280.64, jointly and severally with a co-conspirator, who is awaiting sentencing, and was ordered to forfeit two vehicles purchased with proceeds of the scheme. He and the co-conspirator were involved in a scheme to embezzle $958,280 from NARA. The co-conspirator was responsible for property management and project oversight at NARA's Archives II facility in College Park, Maryland. The defendant was a facility support manager for a company that had a government contract to provide facility management at the Archives II facility. The co-conspirator used his NARA government purchase card to pay three businesses, purportedly operated by the defendant, for goods and services that were never provided or provided at inflated prices. The businesses were listed on contracting documents as 8(a) certified, but there was no record of their 8(a) certification with the SBA. Furthermore, the businesses did not have any offices or employees. The SBA OIG is conducting this investigation jointly with the NARA OIG.

Georgia Business Owner Sentenced. On September 28, 2010, the owner of a Griffin, Georgia company that provided temporary staffing services to various government agencies and departments was sentenced to 5 years probation with community service and a $3,000 fine. She previously pled guilty to one count of making 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 a person who was not a socially and economically disadvantaged in the management and operations of their company. Her false statements resulted in SBA certifying the business as an 8(a) company, allowing it to obtain set-aside contracts valued at about $5.4 million. The SBA OIG conducted this investigation jointly with the DOJ Antitrust Division, the Department of Veterans Affairs (VA) OIG, the Defense Criminal Investigative Service (DCIS), and the U.S. Secret Service.

Eight Companies and Two Individuals Debarred. On September 30, 2010, the U.S. Air Force debarred from Federal contracting six companies affiliated with an Alaskan Native Corporation (ANC) defense contractor headquartered in Yorba Linda, California. In October, it debarred two additional companies and two individuals affiliated with the same ANC defense contractor. The debarments resulted from a multi-agency investigation which found that the principals of the ANC defense contractor and its numerous affiliated business entities conspired to defraud the SBA and the Department of Defense by failing to divulge their secret business and ownership agreements in order to gain preferential treatment under the 8(a) and ANC programs. The OIG is conducting the investigation jointly with the DCIS; the Army Criminal Investigation Command; the Air Force Office of Special Investigations; the Naval Criminal Investigative Service (NCIS) and the FBI.

Settlement Agreements Reached.

- On October 1, 2010, an engineering company and a design build company, both located in Beltsville, Maryland, and their president and owner, agreed to pay the United States $200,000 to settle claims that they used false statements to obtain contracts from several government agencies. The contracts had been set aside for companies that qualified for the Historically Underutilized Business Zone (HUBZone) program. It was alleged that the design build company falsely represented to the SBA and other government agencies that it maintained its principal office in a designated HUBZone location. According to the government, the design build actually operated as part of the engineering company, which was not located in a HUBZone. The design build company obtained HUBZone contracts from the U.S. Army, the Department of Labor (DOL), DHS, and the Smithsonian Institution. The SBA OIG conducted this investigation jointly with the DOJ Civil Fraud Section; DCIS; and the Smithsonian Institution OIG.

- On October 28, 2010, two contracting companies located in Capitol Heights, Maryland and their respective presidents agreed to pay the United States $200,000 to settle claims that they used false statements to obtain contracts from the Department of Defense. The contracts had been set aside for companies that qualified for the 8(a) Business Development and HUBZone programs. The United States alleged that the first company (Company A) and its president falsely represented to the SBA, the U.S. Navy, and the U.S. Army that the company was controlled by a socially and economically disadvantaged individual. The government's investigation found that it was actually controlled by the president of a second company (Company B) who is not socially or economically disadvantaged. The government also alleged that he used Company A's 8(a) status to continue Company B's business operations after its own 8(a) status expired. In addition, the government alleged that Company A and its president falsely represented to the SBA and other government agencies that it maintained its principal office in a designated HUBZone location. In fact, it actually operated out of offices owned by Company B that were not located in a HUBZone. As a result, it obtained contracts that had been set aside by the Air Force for qualified HUBZone companies. The OIG conducted this investigation jointly with DCIS and the DOJ Civil Fraud Section.

Disaster Loans

Duplication of Benefits Between SBA Disaster Loans and Community Development Block Grants. On September 2, 2010, the OIG issued a report on SBA's efforts to prevent duplication of benefits between SBA disaster loans and Community Development Block Grants (CDBG) administered by the Department of Housing and Urban Development (HUD). The Federal Emergency Management Agency (FEMA) has issued regulations establishing a sequence of delivery of Federal disaster assistance to avoid duplication of benefits. Assistance that is ranked higher in the sequence is to be provided before lower-tier assistance. FEMA has also issued guidance indicating that HUD's CDBG awards have the lowest priority in the delivery sequence. The OIG found that funds HUD could have used for additional CDBG awards were used to pay down or reduce undisbursed balances of SBA loans. Specifically, SBA received $643.8 million of CDBG funds from three states (Iowa, Louisiana, and Mississippi) to pay down 19,449 fully-disbursed SBA disaster loans. Additionally, SBA reduced undisbursed loan balances by $281.8 million to avoid duplicate assistance. This shifted $925.6 million in primary assistance from SBA disaster loans, which have to be repaid, to CDBG grants, which are not repaid. As a result, the financial burden on taxpayers was increased and the available grant money for disaster victims who did not qualify for SBA disaster loans was reduced.

The OIG recommended, among other things, that for future disasters, SBA coordinate with HUD and FEMA to formalize a memorandum of understanding to define the functions of each agency in accordance with applicable FEMA guidance.

<u>Louisiana Man Sentenced</u>. On August 26, 2010, a Louisiana man was sentenced to 5 years probation and was also ordered to pay restitution of $43,067 to the SBA and $56,000 to the Louisiana Road Home Program (LRHP). He previously pled guilty to two counts of theft of government funds. The investigation disclosed that he filed an application for a $50,000 SBA disaster loan using an address that was not his primary residence when the Hurricane Katrina struck New Orleans. He also received $56,000 in LRHP grant funds by using the same address. The SBA OIG conducted this investigation jointly with the HUD OIG.

<u>Mississippi Couple Pleads Guilty</u>. On September 13, 2010, a Mississippi couple pled guilty to one count of theft of public funds. During a previous investigation of the wife on separate charges, information was disclosed that alleged that she and her husband had applied for and received disaster relief funds for an address that was not their primary residence. The couple received nearly $300,000 in fraudulent funds, of which $152,000 was from the SBA for a disaster home loan. This case was initiated based on a referral from the U.S. Attorney's Office for the Southern District of Mississippi. The SBA OIG is conducting this investigation jointly with HUD OIG, the Mississippi State Auditor's Office, the DHS OIG, and the Department of Health and Human Services OIG.

<u>Louisiana Couple Indicted</u>. On September 16, 2010, a Louisiana couple were indicted on one count of conspiracy and five counts of wire fraud. The charges involve an SBA loan of $126,300 to another couple to rebuild/repair their residence, which had been damaged by Hurricane Ike. The borrowers gave power of attorney to a financial services company owned by the wife for the purpose of negotiating and finalizing their SBA loan, and the husband was the manager of the company responsible for the repairs to the borrowers' residence. Based on a review of invoices, cancelled checks, and paid receipts submitted to the SBA by the wife in support loan disbursement, the indictment alleges that the cancelled checks were fraudulent and that she and her husband never purchased the items listed on the invoices.

<u>Louisiana Resident Sentenced</u>. On September 22, 2010, a Louisiana woman was sentenced to 1 year and 1 day in prison, 3 years supervised release, and was ordered to pay $150,000 in restitution. She made false statements and submitted false documents to SBA in order to receive a physical disaster loan of $38,800 for Hurricane Katrina damages. Instead of using the loan to repair the family home, she and her husband used the funds, as well as $150,000 in LRHP funds, for other purposes. The husband was previously sentenced for concealing knowledge of his wife's felony. The SBA OIG conducted this investigation jointly with the HUD OIG.

<u>Florida Resident Sentenced</u>. On September 30, 2010, a Florida man was sentenced to 24 months in prison, to be followed by 1 year supervised release, and was also ordered to pay a $5,000 fine. He previously pled guilty to one count of making a false statement to the SBA for the purpose of obtaining a loan. He submitted fraudulent documents to induce the SBA to approve a $143,700 disaster loan for damages to a property that was not his primary residence at the time of Hurricane Wilma. The investigation revealed that he used the disaster loan funds to repair pre-existing

damage not caused by Hurricane Wilma and to pay-off pre-existing debt on the property. The SBA OIG conducted this investigation jointly with the DHS OIG.

Texas Woman Pleads Guilty. On October 1, 2010, a Texas resident pled guilty to knowingly making a material false claim against and upon the SBA for a disaster home loan. The investigation determined that she provided false residential, identification, and employment information, as well as fraudulent supporting documentation when applying for disaster-related assistance with the SBA, FEMA, and the DOL. As a result, she received nearly $80,000 in disaster-related assistance, including a $40,000 SBA loan. The SBA OIG is conducting this investigation jointly with the DHS OIG and the DOL OIG.

Louisiana Resident Pleads Guilty. On October 19, 2010, a Louisiana resident pled guilty to one count of false statements. Following Hurricane Katrina, she applied for and received a disaster loan to rebuild her home in Baton Rouge, Louisiana. She also applied for and received emergency assistance from FEMA and the LRHP. The investigation revealed that she created fraudulent receipts and documents that reflected repair expenses she had supposedly sustained as a result of the storm, but which had not actually incurred. As a result, SBA increased her loan from $85,400 to $108,000. The SBA OIG is conducting this investigation jointly with the HUD OIG, the DHS OIG, and the U.S. Postal Service OIG.

Louisiana Resident Sentenced. On October 27, 2010, a Louisiana man was sentenced to 18 months in prison, 3 years supervised release, $136,952 in restitution to the SBA, and a $200 special assessment fee. He previously pled guilty to two counts of theft of government funds. He was approved for an SBA disaster home loan of $79,500 and a disaster business loan of $70,000. After these loans were approved, he submitted fictitious documents including a lien release, invoices, insurance documents, and contractor proposals in order to mislead and entice the SBA to disburse additional loan funds. The OIG conducted this investigation jointly with the FBI.

Couple Sentenced. On October 28, 2010, a woman was sentenced to 60 months probation, $25,000 in restitution to the SBA, and a $25 special assessment fee, and her husband was sentenced to 36 months probation, $25,000 in restitution to the SBA, and a $100 special assessment fee. Each had previously pled guilty to one count of false or fraudulent claims. The couple was approved for an SBA disaster home loan in the amount of $240,000 for property they owned in Ocean Springs, Mississippi. They claimed this property was their primary residence at the time that Hurricane Katrina hit the Gulf Coast, but they were actually living in California at the time. The couple received loan disbursements of $50,000. The SBA OIG conducted this investigation jointly with the HUD OIG, the DHS OIG, and the Mississippi State Auditor's Office.

Agency Management

Quality Assurance Oversight of the Loan Management and Accounting System (LMAS) Project. On September 13, 2010, the OIG issued a report on a review of SBA's quality assurance (QA) oversight of its LMAS project. The review found deficiencies with the QA plan for the project and disclosed that the QA contractor did not performed all of the QA activities stipulated in its contract, including performance audits of the other LMAS contractors. Further, none of the LMAS task orders that had been issued to date had undergone Independent Verification and Validation (IV&V) testing. These lapses in QA oversight of the project made the Agency unduly reliant on the other LMAS contractors to ensure the quality of their products and increased the risk that the project would not perform as intended.

The OIG recommended that SBA revise the LMAS QA plan; hold the contractor accountable for performing all the activities specified in its contract; and revise the statement of work to include IV&V responsibilities. Further, the OIG recommended that SBA evaluate and make necessary adjustments to the QA manager's workload to ensure that he could devote adequate time to oversee complete implementation of the enterprise QA oversight function.

This update is produced by the SBA OIG,
Peggy E. Gustafson, Inspector General.

The 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 these documents please contact:

SBA OIG
409 Third Street SW., 7th Floor
Washington, DC 20416
E-mail: oig@sba.gov
Telephone number (202) 205-6586
FAX number (202) 205-7382

Many OIG reports can be found on the OIG's website at:

www.sba.gov/ig

If you are aware of suspected waste, fraud, or abuse in any SBA program, please report it online at:

www.sba.gov/ig/aboutus/overview/rsw/index.html

Or call the OIG Hotline toll-free at (800) 767-0385