

# **SEMIANNUAL REPORT OF THE INSPECTOR GENERAL**

## **FOR THE PERIOD**

**April 1, 1995, To September 30, 1995**

### **FOREWORD**

Public Law 95-452 requires the Office of Inspector General (OIG) to prepare an activity report to the United States Congress. This Semiannual Report, transmitted to the Congress by the Administrator of the Small Business Administration (SBA), covers the full range of OIG activities from April 1, to September 30, 1995.

Over the reporting period, the OIG closed 74 investigative cases and obtained 31 indictments and 27 convictions. The office also issued 12 audit reports; 2 inspection reports; and realized \$27 million in potential dollar results (potential recoveries and fines, management avoidances due to investigative activities, disallowed costs agreed to by management, and recommendations that funds be put to better use). These tangible results enabled the Agency to make most of these funds available to qualified small business men and women who are eligible for SBA financial assistance.

For FY 1995, the OIG's fivefold return for every dollar appropriated to its operations represents a prudent investment of the American taxpayer's money. When added to the accomplishments reported earlier this year, I am pleased to report to the Congress that the OIG has had a very successful year: \$47 million in dollar accomplishments; 131 cases closed, with 77 indictments and 78 convictions; and 20 audit reports and 2 inspections issued. Moreover, OIG staff has been engaged in daily consultations with the Agency's program managers in an effort to improve the efficiency and effectiveness of the SBA's programs. Also, the OIG's outreach initiatives have been productive in engaging SBA's resource partners in a constructive dialogue about ways and means of detecting and deterring fraud in their operations.

With one full year's operation completed, our Federal income tax verification initiative continues to perform effectively. With over 55,000 loan applications processed in FY 1995, only 90 problems required the OIG to contact the Internal Revenue Service (IRS) to ensure their resolution. While tax verification represents a strong deterrent to many who might be

inclined to risk falsifying their income when applying for an SBA loan or guarantee, FY 1995 still produced 118 referrals of false tax returns, representing 267 individuals who were denied \$17 million in SBA loans or loan guarantees because of the tax verification program. These statistics are impressive and support the continuation of the program. I am very concerned, however, that after one year's operation and considerable media coverage of this initiative, there were still 267 individuals who were willing to risk the commission of a felony to gain access to SBA's financial assistance programs.

SBA's loan portfolio continues to grow (now approaching \$32 billion), while the OIG's resources remain virtually static. Our limited resources cannot keep pace with the workload we are experiencing across the OIG's divisions, e.g., approximately 160 cases involving over \$20 million in Government funds were declined by the OIG in FY 1995 due to insufficient resources, nor can we be as responsive to the Congress, the SBA Administrator, or other key Agency program personnel as we should be. We are currently carrying 326 investigations in progress, which translates into 1291 subjects and some \$378 million of Government funds at risk. Moreover, many parts of the country are not being covered adequately by the limited numbers of OIG investigative and auditing personnel available, nor are we able to meet the growing demand for audits and inspections being requested by Agency program managers in central office. The OIG, therefore, has had to choose its priorities carefully and set rigorous dollar thresholds for the types of cases it will open and oversight requests it will entertain. This means, of course, that the SBA's business loans and disaster assistance programs continue to receive the lion's share of the OIG's attention, while the balance of the Agency's programs receives little or no independent oversight.

Finally, SBA's policymakers, employees, and program participants have continued to be vigilant and helpful to the OIG in its efforts to ferret out waste, fraud, and abuse in the delivery of SBA's programs. Cooperation received from SBA's senior executives, program managers, and employees during the conduct of OIG audits, inspections, and investigations, as well as throughout the review of our findings and consideration of associated recommendations, continues to be excellent. I remain convinced, therefore, that the more the OIG works with program managers to improve the performance of the Agency during these challenging times of downsizing and fiscal constraints, the better chance we will have to ensure a more efficient and effective SBA. The challenge is clear: to eliminate opportunities for those who would take unfair advantage of SBA programs and, thereby, deny assistance to those honest, small business men and women who are truly in need of the financial assistance being offered by their Government.

**James F. Hoobler**

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## Executive Summary Executive Summary

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This report on the activities of the Office of Inspector General (OIG) of the Small Business Administration (SBA) is submitted pursuant to Section 5(b) of P.L. 95-452, the Inspector General Act of 1978, as amended. It summarizes OIG activities for the 6-month period from April 1, 1995, to September 30, 1995.

### Summary of Accomplishments

OIG audits, inspections, and investigations during this 6-month period achieved \$27,391,466 in potential dollar results, 31 indictments, and 27 convictions. The dollar results consist of: (1) \$4,385,377 in potential recoveries, including judicially-awarded fines and restitution; (2) \$18,857,516 in management avoidances; (3) \$167,790 in disallowed costs agreed to by SBA's management; and (4) \$3,980,783 in management commitments to use funds more efficiently.

As noted in previous Semiannual Reports, the OIG alone could not have achieved the accomplishments set forth in this report to the Congress. The results for this period reflect the cooperation and support of other Federal audit and investigative organizations such as the Federal Bureau of Investigation (FBI), the U.S. Secret Service, the Bureau of Alcohol, Tobacco and Firearms (BATF), the Postal Inspection Service, the Internal Revenue

Service (IRS), and other OIGs; the support of Department of Justice (DOJ) prosecutors; and, most importantly, the actions of SBA program managers and employees. Indeed, much of our success is due to referrals made by conscientious Agency employees.

### OIG Mission for FY 1995

The OIG's challenge in FY 1995 was to focus its resources on those activities with the highest potential for improving the management of the SBA and deterring and detecting the loss of the Federal Government's substantial investment in SBA programs. To meet this challenge, the OIG shifted resources away from traditional oversight activities, i.e., compliance audits with minimal impact and criminal investigations with limited deterrence potential. The office currently concentrates its limited resources on efforts to produce greater dollar savings, to provide maximum deterrence and prevention of fraud, and to secure definitive improvement in SBA's program

efficiency and effectiveness.

The OIG's mission over the next several years will include a special focus on the SBA's disaster assistance program. In late 1994, Congress and the Office of Management and Budget (OMB) made \$3 million available to the OIG for the purpose of disaster-related oversight. The OIG subsequently developed a strategy to guide disaster-related oversight activity and to make optimal use of these funds. Increased temporary staffing located near disaster sites will provide the needed personnel to achieve the goals of the OIG's disaster plan.

The OIG continues to build greater awareness of its mission with SBA employees, the Agency's customers, and its resource partners. The OIG's information dissemination activities should have a significant deterrent effect on fraud, while raising SBA program managers' interest in management improvement. We continue to pursue this dual goal through attendance at SBA-sponsored events, the development and use of more educational presentations, more creative use of key OIG reports and activities, and staff involvement in other initiatives designed to make the OIG more visible with the Agency and its clientele groups. One such example is the OIG's use of IGNet, an Internet-based forum for the inspector general community. Summaries of audit and inspection reports are being made available to the general public on IGNet, which is coordinated for the inspector general community by the SBA/OIG. These are relatively economical methods of reporting our work and they are

having a substantial impact on the accomplishment of our mission and goals.

## **Highlights of the Past Six Months**

### **Efforts to Improve Agency Management**

Annual Financial Audit Results in Qualified Opinion. The annual audit of SBA's FY 1994 financial statements resulted in a qualified opinion for the fourth straight year, i.e., SBA does not maintain comprehensive inventory records of \$148 million of acquired property and fails to value the acquired property at its net realizable value. Except for these issues, the financial statements were presented fairly, meaning that they represent an accurate picture of the Agency's financial condition. In a separate report on management issues, there were nine findings related to general ledger and reporting procedures, electronic data processing internal controls, and other compliance matters.

Deputy Inspector General Testifies on Disaster Assistance Program  
Deputy Inspector General Testifies on Disaster Assistance Program. On May 25, 1995, the Deputy Inspector General (DIG) appeared before the Subcommittee on Government Programs of the House Committee on Small Business to discuss the SBA's disaster assistance program. The DIG summarized investigative, audit, and inspection activities; highlighted two situations which have a major impact on the rising number of fraud cases; and outlined the OIG disaster plan for the use

of the supplemental funding received in FY 1994.

Availability of Credit Elsewhere. An SBA/OIG audit disclosed that the Agency is not strictly enforcing the law that prohibits making SBA-guaranteed loans to persons who can get "credit elsewhere" on reasonable terms. Based on SBA managers' and loan specialists' responses to an audit questionnaire, an estimated \$244 to \$316 million a year is loaned to persons who could have obtained credit elsewhere. Auditors found that both lenders and SBA have incentives—such as the pressure to reduce loan losses—that cause "credit elsewhere" loans to be approved contrary to law and regulations. The SBA's Associate Administrator for Financial Assistance has taken action to improve the understanding of the credit elsewhere provision by issuing a new Agency Procedural Notice.

Section 8(a) Competitive Mix Requirements Studied  
Section 8(a) Competitive Mix Requirements Studied. SBA is not effectively implementing the competitive mix requirements of the Section 8(a) program, thereby permitting companies to develop an unhealthy dependency on sole source, Government contracts. This failure undermines the objectives of the Business Opportunity Development Reform Act of 1988, which requires Section 8(a) companies to increase their non-8(a) sales to be ready to compete after graduating from the program. A recent audit found that SBA's business opportunity specialists were not reacting appropriately to sales reports required by the Act. As a result, many firms received millions of dollars in

Section 8(a) sole source contract awards despite having insignificant levels of non-8(a) business. Companies not complying with the competitive mix targets still managed to receive \$1.4 billion in Section 8(a) contracts in their last year, according to SBA's database in February 1995. The Associate Administrator for Minority Enterprise Development agreed with the audit recommendations to issue more rigorous rules for enforcement of competitive mix and to establish procedures to evaluate post-graduation success in relation to competitive mix.

### **Activities to Enhance Fraud Detection and Deterrence**

SBA/OIG Investigators Receive Deputation as Special Deputy U.S. Marshals.  
SBA/OIG Investigators Receive Deputation as Special Deputy U.S. Marshals. A Memorandum of Understanding (MOU) has been signed by the SBA/OIG, the FBI, and DOJ implementing our part of a 1-year pilot project involving 7 selected OIGs. Under the MOU, all eligible SBA/OIG criminal investigators have been given a blanket deputation as Special Deputy U.S. Marshals. The MOU gives OIG criminal investigators, who have met specified training requirements, full law enforcement powers, including the authority to execute warrants and to carry firearms in the performance of official duties.

Affirmative Civil Enforcement Program. The OIG continues to expand the scope of its efforts to make optimal use of the Department of Justice's Affirmative Civil Enforcement (ACE) program. This U.S.

Attorney-managed program targets cases which might not be prosecuted criminally because of the minimal dollar amounts involved, or because other facts of the case might not support a criminal prosecution.

Heretofore, our ACE results had come from only seven states; however, during this reporting period, the OIG obtained its first ACE results in Indiana and Washington.

During the approximately 27 months the OIG has been involved with the ACE program, we have had a total of 38 successful cases, resulting in \$1,538,403 in civil penalties and \$350,758 in recoveries by SBA. Individual ACE outcomes are reported in the program area chapters.

Results of False Tax Return Cases Increase. Over the last 5 years, the OIG has received 150 allegations that false tax returns were submitted in support of SBA business or disaster loan applications. These fraud referrals, which began to surface in southern California, now represent loan applications submitted to 27 SBA district offices, totaling \$98,418,150 and involving 783 individual subjects. To date, 53 individuals have been indicted on criminal charges: 42 have been adjudicated guilty, 1 indictment was dismissed in the negotiation of her husband's guilty plea, and 10 others have not yet gone to trial.

#### **Internal OIG Management Activities**

Auditing Division Builds Its Presence in the Disaster Assistance Program. Using the

special disaster funding described in the preceding section, the OIG's Auditing Division took steps to establish its presence in the Agency's disaster assistance program. During the reporting period, six auditors were assigned to OIG audit initiatives related to the disaster assistance program--four in Los Angeles and one in Atlanta and Washington, D.C., respectively. Based on surveys conducted at the Los Angeles District Office and the Disaster Area Offices in Atlanta and Sacramento, the OIG has initiated several audit projects. An audit of delinquent and defaulted disaster loans has identified problems in origination, servicing, and liquidation practices; it also has resulted in a number of fraud referrals to the OIG's Investigations Division. Other areas receiving attention include:

- SBA's assignment of disaster-funded personnel in Los Angeles to tasks unrelated to the disaster assistance program;
- SBA's failure to use the Department of Housing and Urban Development's centralized database of Federal debt delinquencies (CAIVRS) in screening disaster loan applicants;
- fraud identification, follow-up, and referral practices at SBA disaster loan servicing centers; and
- staffing, overtime, travel, and administrative procedures in the disaster assistance program.

Survey of OIG Inspection and Evaluation Units  
Survey of OIG Inspection and Evaluation Units. The President's Council on Integrity and Efficiency (PCIE) Committee on Inspection and Evaluation, which is chaired by the SBA's Inspector General (IG), commissioned a survey of all inspection and evaluation units across the inspector general community. The study, which was completed in July 1995, documents the diverse roles of the units, the different ways in which they are structured and staffed, and their perceived benefits. It also provides insight into the relative value of inspection and evaluation units to their respective IGs and their host departments and agencies.

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## Business Loan Program Business Loan Program

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SBA's small business loan programs serve one of the most important missions of the Agency: to ensure that Federal funds and resources are used to help finance qualified small enterprises. Under the **Section 7(a) Guaranteed Loan Program**, SBA guarantees loans to small businesses that are unable to obtain private financing. These loans must be of such merit, or be so secured, as to reasonably ensure repayment to the lending institution. No loan may be made unless the financial assistance is not otherwise available on reasonable terms from elsewhere in the credit market. Under the guarantee plan, SBA agrees to purchase the guaranteed portion of the loan upon default by the small business. SBA's guarantee share of loans by private lenders averages about 80 percent.

More than 8,000 lenders have made at least one Section 7(a) loan in the past 5 years. Currently, approximately 22 percent of these loans are being made by participants in the Agency's **Certified Lender Program (CLP)** or its **Preferred Lender Program (PLP)**.

Lenders who are heavily involved in the SBA guarantee program and meet the Agency's criteria can participate through the CLP. Over 900 participating lenders, approved for the CLP program, are permitted to assume greater authorities and responsibilities in processing, closing, servicing, and liquidating loans. As a result, SBA can process loan guarantee applications in 3 days, rather than the 2 weeks that it may take for a thorough analysis by Agency staff. About 24 percent of all business loan guarantees are made through the CLP process.

As permitted by Section 7(a)(2) of the Small Business Act, SBA delegates even wider authority to preferred lenders, i.e., lenders who can commit the Agency to guarantee eligible business loans and decide the level of SBA participation. This program, with over 259 participants, reduces processing time on strong credit applications and uses the resources of the SBA's best lenders to the maximum. About 8 percent of all business loan guarantees are made through the PLP process.

The **504 Loan Program** provides long-term, fixed-rate financing through certified development companies (CDCs) to small businesses to acquire real estate, machinery, and equipment for expansion of business or modernizing facilities. Typically, 504 loan proceeds are provided as follows: 50 percent by an unguaranteed bank loan, 40 percent by an SBA-guaranteed debenture, and 10 percent by the small business

customer. The maximum SBA debenture is \$1 million.

With the creation of the Agency's Low Documentation (LowDoc) application process, lenders are now able to use their own internal loan application documents, plus a single, two-sided SBA form to apply for an SBA guarantee on a loan of \$100,000 or less. The success of this program is unprecedented: **56 percent of all SBA loan guarantee applications are now submitted through the LowDoc application process.**

## Summary of OIG Activity

The following summarizes OIG activities relating to SBA's business loan programs over the reporting period:

- Three audit reports were issued and five audits were underway.
- Business loan investigations resulted in 19 indictments and 11 convictions.
- Business loan investigations produced \$933,385 in court-ordered restitution to SBA; \$610,656 in civil penalties, fines, and restitution to participating lenders and other third parties; and \$107,000 in reductions to the Agency's financial risk.
- Office of Security Operations name check activity resulted in the declination of 59 business loans, totaling \$14,064,677.
- Twenty-seven business loan investigations were closed, leaving

an inventory of 203 active cases. Due to workload demands, another 33 business loan cases were referred to other law enforcement agencies for investigation, giving us a total of 57 business loan referrals to monitor.

- One piece of legislation, six proposed regulations, and two standard operating procedures (SOPs) were reviewed.

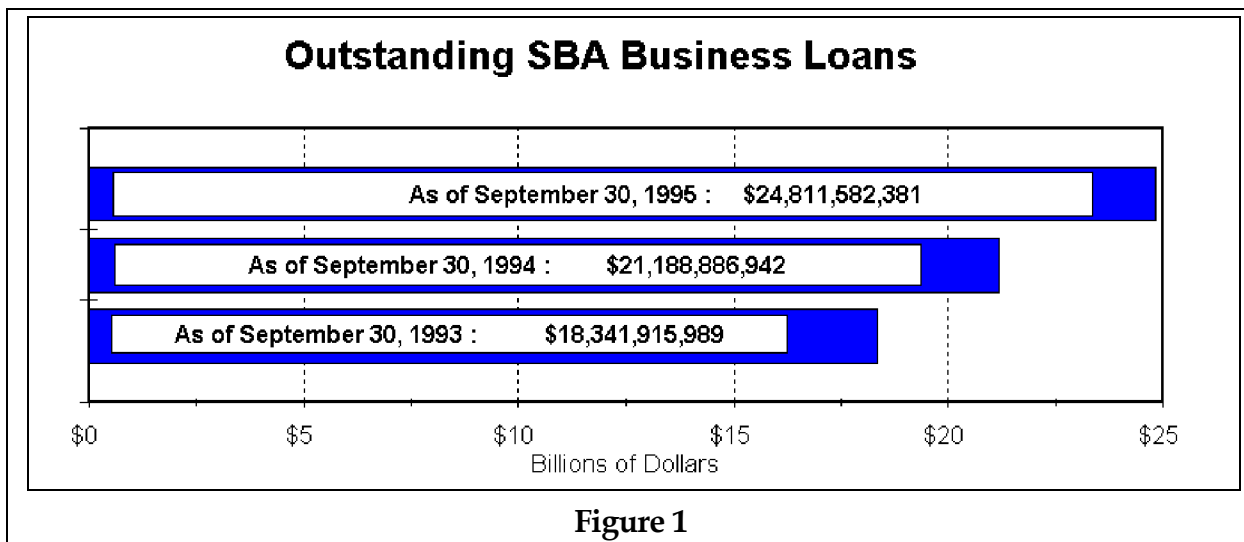
## Efforts to Improve SBA Program Management

### SBA Loans Made to Borrowers Who Could Get Credit Elsewhere SBA Loans Made to Borrowers Who Could Get Credit Elsewhere

Based on a survey of SBA managers, the OIG estimated that \$244 to \$316 million a year is **loaned to persons who could get "credit elsewhere," contrary to law and SBA regulations.** In an audit report issued in September 1995, the OIG recommended improved procedures to assure that District Offices and lenders

adhere to the credit elsewhere rule.

The Associate Administrator for Financial Assistance has initiated the corrective actions recommended in the audit report, including issuing a new Agency notice clarifying the credit elsewhere requirement.



Section 7(a) of the Small Business Act authorizes SBA to expand capital availability to small businesses by guaranteeing loans made by banks to persons who cannot obtain credit elsewhere on reasonable terms. SBA regulations require consideration of several sources of credit elsewhere: a conventional loan from the same bank, a conventional loan from another bank, and the borrower's own resources.

Borrower resources that are counted as credit elsewhere include securities; assets not needed for growth of the business; and personal resources of the owner, management, or principal shareholders. The regulations exempt life insurance, individual retirement accounts, educational reserve and \$50,000 per family from the "credit elsewhere" consideration. Lenders certify to SBA on each guaranteed loan application that they would not make the loan without the guarantee.

Two questionnaires were used in the audit to analyze the perceptions and attitudes of SBA field office personnel during the period from October 1992 through June 1994. One questionnaire was completed by district directors and assistant district directors. The other questionnaire was completed by loan specialists selected at random.

The questionnaire responses raised concerns that some SBA managers and loan specialists may tolerate loans to borrowers who could get credit elsewhere. A total of 66 of 130 managers perceived correctly that the Section 7(a) program is "definitely" restricted to persons who cannot get credit elsewhere. Those answering "No" (11) or "Qualified Yes" (53) to the question of whether the program was "definitely" restricted, attributed their opinion to a variety of contributing factors: SBA management no longer emphasizes enforcement of the credit elsewhere rule, lenders would not participate if the rule were strictly

enforced, high quality loans are needed to keep loss rates from rising, and others.

Although SBA relies on the lender certification, more than half of the loan specialists and 28 percent of the managers said that lenders "seldom" or "never" adequately address the credit elsewhere requirement in preparing loans for SBA guarantees. The various types of credit available elsewhere identified in prior audits were ignored by from 9 to 35 percent of the loan specialists answering the questionnaire.

Most of the loan specialists said they had seen applications with credit available elsewhere, and they estimated that the indicators were present in 6.7 percent of preferred lender applications and 8.2 percent of regular and certified lender applications. Furthermore, loan specialists estimated that 37.5 percent of the loans with credit elsewhere indicators were approved anyway. Managers estimated that 3.9 percent of approved loans had credit elsewhere indicators. Applying the managers' percentages to SBA's \$8.1 billion in loan approvals in 1994 gives an overall estimate of \$316 million in loans approved with potential credit available elsewhere.

About half of the loan specialists and a third of the managers agreed with the proposition that making loans to borrowers with credit elsewhere diverts funds from more needy applicants. Making some credit elsewhere loans can result in unfair competition between banks, a situation not contemplated by the Small Business Act, causing some non-SBA lenders to complain that they are

losing conventional loans to lenders making SBA-guaranteed loans.

### **SBA Withdraws Loan Guarantee from California Firm SBA Withdraws Loan Guarantee from California Firm and Finds Loan Administration Errors at SBA's Los Angeles District Office Loan Administration Errors at SBA's Los Angeles District Office**

An audit report on an \$825,000 guaranteed revolving line of credit to a Los Angeles consulting firm identified four deficiencies by a participating lender bank in originating and servicing the loan. In processing the loan application, the bank improperly allowed a distribution of \$122,000 to the owner to be treated as a current asset and did not disclose this information to the SBA. In servicing the loan, the bank neither detected nor reported to SBA three adverse conditions totaling \$417,257.

During the audit, the OIG recommended that the Director of the Los Angeles District Office terminate the loan guarantee of \$580,000. The recommendation was accepted by the District Office, and the bank agreed to release SBA of liability on the loan guarantee.

As a result of the audit described above, auditors found that the SBA Los Angeles District Office made **errors in the origination and administration** of the \$825,000 working capital loan guarantee. The District Office staff did not reconcile conflicting Standard Industrial Classification (SIC) code information and issued the loan guarantee under an

incorrect SIC code. The borrower may have exceeded the size standard for its correct SIC code and may have been ineligible for the loan. The District Office also approved an excessive 65 percent increase in the loan, almost double the maximum allowable increase of 33 percent, and erroneously advised the lender that a \$200,000 advance to a relative was permissible.

On another issue, auditors noted that the applicant was delinquent \$900,000 on Federal income taxes at the time the loan was approved by SBA. The District Office relied on an SBA policy that permitted a loan to be made under these circumstances, if there was a repayment plan approved by the Internal Revenue Service. The audit found, however, that other SBA policies that require consideration of the borrower's character were not applied in evaluating this loan. The audit recommended that SBA strengthen its procedures for considering the character issue when the borrower has a tax delinquency. The Associate Administrator for Financial Assistance agreed with the audit recommendation.

### **OIG Fact-Finding Team Visits a Midwest Bank OIG Fact-Finding Team Visits a Midwest Bank**

In September, members of the OIG executive team met with the Senior Vice President/Chief Auditor and the Executive Vice President/Chief Credit Officer, and members of their staffs, at a participating lender bank in Minneapolis, Minnesota. The discussion agenda included credit policy and administration, problem loan administration, audit of credit activities, and loan fraud detection and prevention. The visit provided an appreciation of how a quality lending institution can protect the Government's interest by using its credit policy, standards, and procedures efficiently and effectively. It also generated ideas that the OIG is pursuing to assist the SBA in improving the oversight of its business loan program.

### **Review of SBA Legislative Proposal for Maximum Loan Guarantee Review of SBA Legislative Proposal for Maximum Loan Guarantee**

We reviewed an SBA legislative proposal that would reduce the maximum SBA guarantee for business loans but would still permit a higher guarantee percentage (85 percent) for loans under \$100,000. These LowDoc loans now account for more than half of all SBA guaranteed loans, and there have been some industry concerns that many lenders are not analyzing these loans sufficiently, leading to a higher projected default rate. The OIG, therefore, recommended lowering the guarantee rate to 75 percent to encourage lenders to be more prudent in their lending decisions. After due consideration, Agency officials decided not to adopt the OIG recommendation, but they stated that they would monitor the LowDoc program carefully.

### **Review of Section 504 Loan Program Regulations Review of Section 504 Loan Program Regulations**

The OIG reviewed a proposed amendment to 13 C.F.R. Part 108 governing the collection of fees and the use of interest accruing in accounts established to administer the Section 504 Certified Development Company (CDC) loan program, and had two significant concerns. First, Section 108.504(e)(3) would allow the Central Servicing Agent's (CSA) compensation to be paid from initiation fees on specific loans or from aggregated service fees, but it does not define the source of funds that will comprise the "aggregated service fees." The OIG recommended that this oversight be clarified and suggested that one approach would be to identify the funds as the difference between the servicing fee paid by the borrower (1/10th of 1 percent) and the CSA's servicing fee (3/64ths of 1 percent). Program officials agreed to address this issue by publishing updated notices of fee changes.

Second, Section 108.504(e)(4) would provide that funds in the master reserve account representing interest not attributable to a specific Section 503 company may be expended by SBA for program administration purposes. This appears to be contrary to the provisions of the Treasury Financial Manual, Volume I, Part 6, Sections 3020 and 3030, which require that these types of funds be turned over to the Treasury. Program officials agreed to clarify this provision by specifying that only those funds in the master reserve escrow account, representing interest earned prior to

October 1991 and not distributed to a specific Section 503 company, may be used for program administration.

**Review of Accredited Lenders Program for Certified Development Companies**  
**Review of Accredited Lenders Program for Certified Development Companies**

The OIG reviewed a proposed SBA Notice and Guide to the Accredited Lenders Program (ALP) and made several recommendations to improve the administration of the program. We noted that the Guide provides that, before approving a renewal of an ALP designation, the District Office shall make a field visit to the ALP-CDC to review the adequacy and completeness of the CDC's files. We suggested that, in addition to this visit and review, the District Office consider additional criteria in renewing an ALP designation, including: (1) a loss rate threshold; (2) a currency rate threshold; and (3) adequate CDC compliance with all applicable SBA procedures, as determined by on-site reviews, with an emphasis on credit analysis and borrower and loan eligibility determinations.

The Guide also requires ALP-CDCs to assemble loan packages, ensure their completeness, and include all necessary exhibits. We recommended that some language be included to hold ALP-CDCs responsible for referring to the OIG's Investigations Division any evidence of false statements or other suspected violations of Federal law of which the ALP-CDC may become aware. We also recommended that instructions be

provided to the ALP-CDCs as to their responsibilities, and that established procedures be followed in obtaining fingerprints and forwarding such information to the OIG, whenever a loan applicant provides a "Yes" answer on the Form 912. Program officials concurred with our recommendations and included language in the Guide that addressed our concerns.

**Activities to Enhance Fraud Detection and Deterrence**

**Newest Results from Affirmative Civil Enforcement (ACE) Program**  
**Newest Results from Affirmative Civil Enforcement (ACE) Program**

During this period, the OIG's participation in the Department of Justice's ACE program produced an additional 11 successful business loan cases, resulting in \$169,224 in civil penalties ranging from \$750 to \$47,714. All 11 cases involved fraudulent representations in applications for loans that were stopped before funds were disbursed. All but one case, a Texas real estate company, involved applications to Federally-insured lenders. Two of the cases represent the OIG's first ACE results in the state of Washington.

**Indictment Charges that New York Company Was a Racketeering Enterprise**  
**Indictment Charges that New York Company Was a Racketeering Enterprise**

A Syracuse, New York, computer software development company, its chief executive officer (CEO), and an attorney and business consultant for the company were charged in a 54-count Federal indictment. The CEO was charged with running the company as a **criminal enterprise under the Racketeer Influenced and Corrupt Organization statute** and with **racketeering conspiracy**. Specific charges against him included **wire fraud, mail fraud, bank fraud, bankruptcy fraud, and money laundering**. The CEO and the attorney were also charged with **perjury**, and the corporation was charged with **mail fraud** and **bank fraud**. The investigation disclosed that the company and its CEO defrauded SBA and a participating lender bank by failing to disclose a significant debt in an application for a \$750,000 SBA-guaranteed loan. A substantial portion of the loan proceeds were used to pay off that debt. They also defrauded the Government by submitting false information in connection with a \$7 million Navy contract. In addition, the investigation revealed that the CEO transferred company assets and concealed these transfers from the bankruptcy court, defrauded his corporate investors, laundered funds obtained by the company from the SBA-guaranteed loan and its corporate investors, and made a false sworn statement in connection with the Navy contract. The attorney was charged with perjury based on statements he had made to the grand jury that returned this indictment. The OIG conducted this investigation jointly with the Defense Criminal Investigative Service, which brought the case to our attention.

### Idaho Couple Sentenced for Making False Statements Idaho Couple Sentenced for Making False Statements to a Federally-Insured Lender and SBA

A Boise, Idaho, businessman pled guilty to, among other financial crimes, **making false statements** to a Federally-insured lender and to SBA. The charges resulted from the submission of false tax return information in support of an \$80,000 SBA-guaranteed loan application. He was sentenced to 41 months imprisonment, 4 years supervised release, and a \$4,250 fine. For her part in this scheme, his spouse was sentenced to 4 weekends imprisonment, 4 months home detention, 3 years supervised release, and 200 hours of community service. She was also ordered to sign over to the bankruptcy court her home (valued at \$44,000) and her \$15,000 truck. She had claimed that she operated the condiment company, when, in fact, it was her husband who ran the operation. The couple engaged in this deception because, if SBA had known the truth, the loan would have been declined because of the man's prior criminal fraud convictions. The OIG's joint investigation with the IRS and the FBI was initiated based on information received from the SBA Boise District Office.

### Two More Individuals Sentenced in Ongoing Southern California Loan Packager Investigation Southern California Loan Packager Investigation

Two more persons have been sentenced as a result of the OIG's investigation of a southern California packager of SBA-guaranteed loans:

- The former owner of a Santa Ana, California, machine shop was sentenced to 30 days imprisonment, 5 years probation, 3,000 hours of community service, and \$81,452 in restitution to SBA. The OIG's joint investigation with the FBI disclosed that he had made **false statements** on his application to obtain a \$100,000 SBA-guaranteed loan.
- A former vice president and manager of the SBA loan department of a Pasadena, California, bank was sentenced for **making false entries on bank documents, embezzlement by a bank officer, and acceptance by a bank officer of corrupt payments**. He was sentenced to 21 months imprisonment, 3 years supervised release, and restitution of \$35,477 to SBA and \$26,450 to the Pasadena bank. The investigation was carried out in two phases. Initially, the bank officer was found to have accepted more than \$35,000 from a southern California loan packager representing various borrowers, in exchange for his approval recommendations on the borrowers' loan applications while he was employed as a loan officer at a City

of Industry, California, bank.

The second phase of the investigation was initiated following the manager's guilty plea to **accepting the corrupt payments**. At the request of SBA's Los Angeles District Office, the Pasadena bank, where he was employed at the time of the initial guilty plea, performed an audit of all loans processed by him. The audit discovered that he had falsified SBA compensation agreements by failing to disclose that a third party finance company was paid to "package" numerous SBA loans. He also had failed to disclose to the bank that he was the actual loan packager working for that company and that he was then paid by the finance company for his packaging services. The former bank officer also had improperly approved payment by the bank of the company's invoices for loan packaging services on a number of non-SBA loans, even though no packaging had been done; this action constituted embezzlement of bank funds. The packaging company received a total of \$38,450 from the Pasadena bank, and the investigation showed that the bank officer received most of that total for himself.

The OIG initiated this investigation based on a referral from SBA's Los Angeles District Office.

### **More Californians Plead Guilty to Using False Tax Returns More Californians Plead Guilty to Using False Tax Returns to Get Loans**

Three more Californians have entered guilty pleas as a result of the OIG's joint investigation with the FBI regarding the inclusion of false tax returns in applications for SBA-guaranteed business loans:

- The former owner of a Los Angeles area machinery distribution business pled guilty to **making false statements** to obtain an SBA-guaranteed loan and was sentenced to 5 years probation and \$131,015 in restitution to the participating lender bank. The man obtained a \$150,000 loan after submitting false income tax returns as part of his loan application.
- A Los Angeles sportswear manufacturer and retailer and his wife were charged in a superseding indictment on 13 counts and 2 counts, respectively, of **submitting a false loan application to a Federally-insured financial institution**. The man pled guilty to five counts (the others will be dismissed by the court in return). The wife pled guilty to one count in connection with a bank loan for the purchase of her business, a Culver City, California, shoe store, the other count was dismissed.

As previously reported, the businessman was originally charged with five counts of **submitting a**

**false loan application to a Federally-insured financial institution** in connection with his \$465,000 SBA-guaranteed loan. Following that indictment, the investigation was expanded to pursue additional potential violations in connection with other loans; this portion of the investigation resulted in the additional charges. The investigation disclosed that, in addition to the SBA-guaranteed loan, applications for four other loans (a \$14,500 automobile loan, a \$412,000 residential loan, a \$200,000 loan for her business, and another \$712,000 residential loan) all contained false tax returns.

The OIG initiated the investigation in response to a referral from SBA's commercial loan servicing center in Fresno, California.

### **Indiana Businessman Sentenced for Making False Statements Indiana Businessman Sentenced for Making False Statements to SBA, Bank Fraud, and Wire Fraud**

The president and owner of an Indianapolis, Indiana, clothing manufacturer pled guilty to an information that charged him with scheming to defraud SBA, a participating lender bank, and a private financing business. The businessman pled guilty to three counts: **making false statements to SBA, bank fraud, and wire fraud**. He was sentenced to 28 months imprisonment, 5 years supervised release, restitution of \$9,250 to the private financing business and \$3,567 to the bank, and a \$2,150 fine. The OIG investigation disclosed that he made false statements to SBA and the bank to conceal an outstanding debt as well as his prior criminal history. The investigation also disclosed that he submitted a falsified invoice, claiming that his company had a \$42,000 account receivable, to obtain \$22,912 in loan proceeds from the private financing business; the funds were subsequently wire-transferred to the bank. The investigation was opened based on a referral from SBA's Indianapolis District Office.

### **Three Associated with Ohio Manufacturer Charged with FraudOhio Manufacturer Charged with Fraud**

Three midwestern businessmen associated with a motor-manufacturing company in Mentor, Ohio, have been charged with participating in a fraud scheme involving a \$400,000 SBA-guaranteed loan. Two personal guarantors of the loan were indicted on charges of **bank fraud, wire fraud, and making false statements in a loan application to a Federally-insured financial institution**, and the corporation's president was charged with one count of **making a false statement in a loan application to a Federally-insured financial institution**. The OIG's joint investigation with the FBI revealed that, over a period of nearly 3 years, the guarantors carried out a scheme to defraud a participating lender bank in Cleveland, Ohio by submitting falsified individual tax returns and financial statements overstating their adjusted gross incomes and personal net worths. The company's president, in signing the Authorization and Loan Agreement, represented that the use of the proceeds of the loan would be limited to the purchase of machinery, equipment, furniture, and fixtures when he knew that proceeds were being diverted to him and his two co-defendants. The OIG initiated the investigation based on a referral from SBA's Cleveland District Office.

### **Florida Business Owner Sentenced for Submitting False Loan ApplicationFlorida Business Owner Sentenced for Submitting False Loan Application**

The owner of an herbal products company located in Jupiter, Florida, was sentenced to 16 months incarceration, 3 years supervised release, and restitution to SBA of \$13,796. He previously had pled guilty to **submitting a false loan application to a Federally-insured financial institution**. The OIG investigation found that he obtained a \$50,000 SBA-guaranteed loan by lying about a prior bankruptcy and how he intended to use the loan proceeds. After receiving checks co-payable to vendors, he canceled the orders from those vendors, obtained refunds, and used the money for his own benefit. The OIG initiated the investigation based on a referral from SBA's Jacksonville District Office.

**Georgia Caterer Sentenced for  
Defrauding Financial  
Institutions**

The owner of a now-defunct Atlanta, Georgia, catering company pled guilty to an information charging her with two counts of **theft of property of Federally-insured financial institutions**. In return, the 40 felony counts on which she had been indicted in 1991 were dismissed. She was subsequently sentenced to 3 years probation, restitution of \$650,000 to SBA and \$180,000 to a Georgia savings bank, and a \$25,050 fine. The OIG investigation, based on a referral from SBA's Atlanta District Office, disclosed that she and her husband defrauded SBA and seven Federally-insured lenders out of more than \$1.2 million. The couple had fled the country prior to their 1991 indictment, but in January 1995 she was deported from Russia to the United States. Efforts are being made to return her husband, who was recently located in Cyprus, to the United States to stand trial on 42 felony counts.

**California Father and Daughter  
Indicted on Conspiracy  
Charge**

A California father and daughter were each indicted on one count of **conspiracy** and one count of **making a false statement in a loan application to a Federally-insured financial institution**. The investigation revealed that the daughter, who received a \$665,000 SBA-guaranteed loan to purchase real property in Woodland Hills, California, to operate a nursery, submitted false financial documents, including false tax returns, to obtain the loan. Her father purchased the property for \$450,000 and then immediately sold it to her for \$900,000. The father also falsely represented to the bank that he was giving his daughter a gift of \$160,000 to purchase the property. The nursery never opened for business, and the loan went into default after only two loan payments had been made. Arrest warrants have been issued for the pair, one or both of whom may have left the country. The case was referred to the OIG by SBA's Los Angeles District Office.

### **Two More Georgia Businessmen Charged with Loan Fraud Scheme Two More Georgia Businessmen Charged with Loan Fraud Scheme**

The owner of a Georgia corporation which sold land and a building in LaGrange, Georgia, to a restaurant owner was indicted on two counts of **making false statements** to SBA and one count of **conspiracy**. The proprietor of the now-defunct LaGrange restaurant was indicted on the same **conspiracy** count; he had previously been indicted on eight other felony counts in this case. The restaurant owner had received a \$400,000 SBA-guaranteed loan from a non-bank lender in 1990. The new counts charge that the two men schemed to fabricate documentation of a capital injection into the restaurant, which was required by SBA to guarantee the loan. Also, an attorney involved with the sale of the land and building pled guilty to a criminal information that charged him with one misdemeanor count of **theft of property of a Federally-insured financial institution**. The OIG initiated this investigation based on a referral from SBA's Atlanta District Office.

### **Washington Restaurant Owner Pleads Guilty to Making False Statements Washington Restaurant Owner Pleads Guilty to Making False Statements**

The former owner of a restaurant in Sequim, Washington, was indicted on six counts of **making false statements** to SBA. He subsequently pled guilty to one count, and in return, the U.S. Attorney's Office agreed to dismissal of the other charges. The investigation disclosed that the man made numerous false statements to induce SBA to approve and disburse a \$45,000 Vietnam-Era Veteran direct SBA loan. He was charged with understating his personal and business debts and with concealing his misuse of loan proceeds by submitting forged and altered invoices and other false documents to SBA. The restaurant owner defaulted on the loan with an outstanding balance of approximately \$43,000. This matter was referred to the OIG by a loan officer in SBA's Seattle District Office.

### **Missouri Bank Owner Pleads Guilty to Falsifying Bank Records Missouri Bank Owner Pleads Guilty to Falsifying Bank Records**

A former banker and business owner pled guilty to making or causing a **false entry** in the records of a Missouri bank, of which he was an owner. He had been charged with using the bank's funds to pay approximately \$76,000 in expenses incurred by another bank, which he also owned, and with having these payments falsely recorded as expenses of the first bank. This OIG joint investigation with the FBI was initiated in response to a referral from the SBA's Kansas City District Office.

### **Kansas Automobile Dealership Manager Sentenced for His Part in Fraud Conspiracy Kansas Automobile Dealership Manager Sentenced for His Part in Fraud Conspiracy**

The former manager of an automobile dealership in Ottawa, Kansas, was sentenced to 3 years probation and a \$50 special assessment. He had pled guilty to one count of **conspiracy** to commit mail fraud by filing an insurance claim in connection with a fire which destroyed the dealership. The OIG's joint investigation with the BATF disclosed that the manager and three other men conspired to make false statements to SBA and others to obtain financing (including a \$150,000 SBA-guaranteed loan) for the dealership. They later conspired to burn it down and fraudulently collect the insurance proceeds. As a result of the fire, losses to the automobile manufacturer and others totaled about \$453,000. The manager agreed to cooperate in the prosecution of the three others (the dealership's owner and the two men the owner allegedly paid to set the fire) on charges of **conspiracy, arson, and mail fraud**; however, at the conclusion of their trial, all three were acquitted for undetermined reasons. The application for the \$150,000 SBA-guaranteed loan was declined. The OIG joined this investigation at the request of the BATF.

**Missouri Businessman Pleads Guilty to Overvaluing Assets**  
**Missouri Businessman Pleads Guilty to Overvaluing Assets to Obtain Bank Loans**

A former partner in a Branson, Missouri, novelty item company pled guilty to a one-count information that charged him with making **false statements in loan applications to a Federally-insured financial institution**. The investigation disclosed that the businessman overvalued his company's inventory and accounts receivable by more than \$240,000 each to obtain a \$1,250,000 line of credit and a \$775,000 SBA-guaranteed loan. The borrower made no payments on these loans before they defaulted. The plea agreement stated that the readily provable loss attributable to the businessman's conduct was \$495,000. This investigation was conducted jointly by the FBI and the OIG, which initiated its case based on a referral from SBA's Springfield, Missouri, Branch Office.

**California Landscaper Charged With Fraud in Second Set of Loans**  
**California Landscaper Charged With Fraud in Second Set of Loans**

The owner of a landscape maintenance company in Anaheim, California, was charged in a criminal information with two counts of **making false statements in loan applications to Federally-insured financial institutions** and two counts of **filing false tax returns**. These charges stemmed from a follow-on investigation based on a report by the man's bookkeeper, that produced his February 1995 guilty plea to a felony charge for fraud in obtaining a \$400,000 SBA-guaranteed loan. Suspecting that this was not the first time the man had used false documents to obtain bank loans, the prosecutor requested that the OIG examine the files of the man's other loans. This led to both the identification of another two bank loans which were obtained with false tax returns and the discovery that the man was under investigation by the IRS for other suspected crimes. The OIG then joined forces with the IRS in the investigation which resulted in the more recent charges.

**New York Bank Officer Indicted for  
Illegally Soliciting Commissions  
New York Bank Officer Indicted for  
Illegally Soliciting Commissions**

A former vice president of one of the largest SBA lender banks in New York City was indicted on three felony counts. The indictment charged that the man **solicited commissions for procuring loans** which were guaranteed by SBA, in return for his assistance in obtaining loan approvals. The OIG investigation, conducted jointly with the FBI, disclosed that he demanded cash fees from two applicants as a condition for approving their loans. He also ordered a subordinate bank employee to demand cash from a third applicant. The illegal commissions totaled \$17,000 on loans totaling more than \$800,000. The investigation was initiated based on information received from a confidential source.

**California Loan Packager Indicted for  
Causing False Statements to Be  
Made  
California Loan Packager  
Indicted for Causing False Statements  
to Be Made**

A Garden Grove, California, loan packager was indicted on 23 counts of **causing false statements to be made in loan applications to Federally-insured financial institutions**. The indictment charges that he caused 18 false tax returns to be included with 8 SBA-guaranteed loan applications submitted to a Santa Ana, California, bank and 5 false tax returns to be included with 2 SBA-guaranteed loan applications submitted to an Anaheim, California, bank. The joint OIG/FBI investigation, initiated in 1990 based on information provided by the Santa Ana District Office, involved 32 loans packaged by this man. To date, 20 of the loans have defaulted, resulting in more than \$3.2 million in losses to SBA and the banks. An investigation of several of the borrowers is continuing.

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## Disaster Loan Program Disaster Loan Program

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SBA's disaster loans, made pursuant to Section 7(b) of the Small Business Act, as amended, represent the primary form of Federal assistance for non-farm, private sector disaster losses. For this reason, the **Disaster Loan Program** is the only form of SBA assistance not limited to small businesses. Disaster loans from SBA help homeowners, renters, businesses of all sizes, and non-profit organizations fund rebuilding. SBA's disaster loans are also a critical source of economic stimulation in disaster-ravaged communities, helping to spur employment and stabilize tax bases.

By providing disaster assistance in the form of loans which are repaid to the U.S. Treasury, the SBA disaster loan program helps reduce Federal disaster costs compared to other forms of assistance like grants. When victims need to borrow to repair uninsured damages, the low interest rates and the long terms available from SBA make recovery affordable. Because SBA tailors the repayment of each disaster loan to each borrower's capability, unnecessary interest subsidies paid by the taxpayers are avoided.

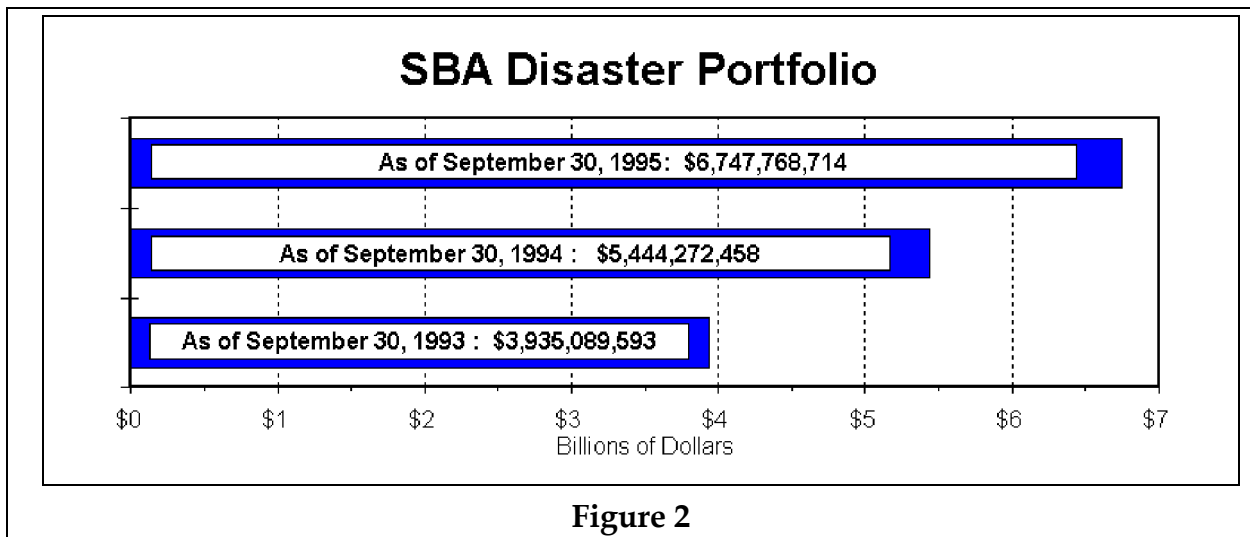
The need for SBA disaster loans is unpredictable. During FY 1995, SBA approved 45,041 loans for \$1.21 billion. During FY 1994, in the aftermath of the Northridge earthquake, Tropical Storm Alberto, the Great Midwest Floods, and other disasters, SBA approved 125,861 loans for an all-time record amount of \$4.16 billion. Since the inception of the program, SBA has approved more than 1,303,000 disaster loans for more than \$23 billion. As of the end of FY 1995, the SBA disaster loan portfolio included more than 271,000 loans valued at over \$6.7 billion. The total available for FY 1996 disaster loans, including carryover and contingency funds, is approximately \$568 million.

SBA is authorized by law to make two types of disaster loans: (1) physical disaster loans, which are a primary source of funding for permanent rebuilding and replacement of uninsured disaster damages to real and personal property homeowners, renters, businesses of all sizes, and non-profit organizations; and (2) economic injury disaster loans (available by law only to small businesses), which provide necessary working capital until normal operations resume after a physical disaster. SBA delivers disaster loans through four specialized Disaster Area Offices located in Niagara Falls, New York; Atlanta, Georgia; Fort Worth, Texas; and Sacramento, California.

## Summary of OIG Activity

The following summarizes OIG activities relating to SBA's disaster loan programs during the reporting period:

- Five audits were underway during the period.
- Disaster loan investigations resulted in 7 indictments and 12 convictions.
- Disaster loan investigations produced \$442,100 in court-ordered restitution to SBA, \$286,286 in other recoveries by SBA, \$39,750 in fines and special assessments, and \$35,400 in reductions in financial risk.
- Office of Security Operations name checks resulted in the declination of 17 disaster loans totaling \$4,650,439.
- Sixteen disaster loan investigations were closed, leaving an inventory of 61 active cases. Due to workload demands, another four disaster loan cases were referred to other law enforcement agencies for investigation, resulting in a total of ten disaster loan referrals to monitor for performance.
- Two proposed regulations and one SOP were reviewed.



## **Efforts to Improve SBA Program Management**

### **Deputy Inspector General Testifies on Disaster Assistance Program Deputy Inspector General Testifies on Disaster Assistance Program**

On May 25, 1995, the Deputy Inspector General (DIG) appeared before the Subcommittee on Government Programs of the House Committee on Small Business to discuss the SBA's Disaster Assistance program. The DIG summarized investigative, audit, and inspection activities to date; highlighted two situations which have a major impact on the number of fraud cases; and outlined the OIG Disaster Plan for the use of the supplemental funding received in FY 1994. A short synopsis of her testimony follows.

Since 1990, the Investigations Division has initiated 148 criminal investigations involving 533 subjects and approximately \$64 million in potential losses from disaster loans. To date, 79 individuals have been indicted and \$5.3 million has been recovered through court-ordered restitution, fines, or savings. The current inventory consists of 65 active cases involving 414 subjects and \$45 million in potential Government losses.

Two situations have had a significant impact on the number of fraud cases stemming from disasters: (1) the use of falsified copies of Federal income tax returns or other financial data submitted with loan applications and (2) the marked increase in false applications prepared by

"loan packagers." The DIG reported that the number of investigative referrals including allegations of false tax returns or other financial data has declined significantly since all loan applicants have been required to sign a waiver allowing the SBA to obtain Federal income tax information from the IRS. In response to the loan packager problem, the Administrator has also created a Fraud Prevention Task Force to develop and present recommendations for protecting the public and the SBA from unscrupulous packagers and others who might try to take advantage of the Agency's programs. The Task Force's report should be completed by the end of the next reporting period.

In addition to providing support for ongoing fraud investigations, the OIG's Auditing Division completed a study to determine the validity of applications submitted 10 months after the Northridge earthquake. The report concluded that these applications were based on actual damages and there were a number of legitimate reasons for the delay in submitting applications. In some cases, however, the delay in filing made it difficult to determine precisely if the damages were caused by the earthquake. The DIG also discussed the Division's current audit work in Los Angeles involving loans in liquidation and the audit survey work in Atlanta that has just begun. The expected results from this audit activity should include both additional referrals to the OIG's Investigations Division and recommendations to disaster assistance program managers for systemic

improvements.

Under the OIG Disaster Plan, the Investigations Division has hired six criminal investigators, using temporary appointment authority, to help handle the ever-increasing disaster assistance workload. Also, pursuant to the Disaster Plan, the OIG's Auditing Division has hired six auditors who are dedicated to the analysis of both known and potential problem areas in the disaster assistance program.

### **Disaster Loan Processing SOP Reviewed**

The OIG reviewed SBA's proposed comprehensive revision of SOP 50 30, **Disaster Loan Processing**, and made several comments and suggestions. We suggested that the SOP inform disaster employees of specific criminal acts, such as bribery overtures, attempts, or solicitations which should be reported immediately to the OIG. We suggested further that the OIG "Fraud Line" telephone number be listed in the SOP; both recommendations were accepted by the Associate Administrator for Disaster Assistance (AA/DA). The OIG review also expressed concern that the proposed revision did not fully explain the phrase "caution should be exercised," which had been used in the section explaining the repayment analysis applicable to determining the loan eligibility of resident aliens. The AA/DA agreed and supplied a clearer statement intended to alert Loan Officers to potential problems. We also suggested that the \$250 allowance for reimbursement for the loss of alcoholic beverages be removed. The AA/DA

explained that the amount was a limitation, and that it would not be appropriate for them to make such a moral decision. Finally, we expressed concern over the section addressing "Lending for the [Insurance] Deductible Only," because we felt that the paragraph did not fully explain the concept of lending money to individuals to cover their insurance deductible. Moreover, it created possible loopholes for potential borrowers. The AA/DA agreed and drafted new wording which addressed our concern.

### **Activities to Enhance Fraud Detection and Deterrence**

#### **Results from Affirmative Civil Enforcement (ACE) Program Results from Affirmative Civil Enforcement (ACE) Program**

During this period, the OIG's participation in the Department of Justice's ACE program produced two successful disaster loan cases, resulting in \$10,500 in civil penalties and \$130,446 in recoveries by SBA. One case produced the payoff in full of a disaster loan, plus \$500 awards for costs to both SBA and the Department of Justice. The other case, which involves a bowling alley and is discussed in detail at the end of this chapter, represents the OIG's first ACE result in Indiana.

## Ongoing Investigation into California Disaster Loan Packagers Ongoing Investigation into California Disaster Loan Packagers Yields More Results

The joint OIG/Secret Service investigation of false disaster loan applications prepared by two southern California brothers acting as loan packagers has yielded additional results. Eight men, whose guilty pleas to **submitting false claims** to SBA we had previously reported, were sentenced:

- An Encino, California, businessman was sentenced to 3 years probation and a \$5,000 fine. He had applied for a \$150,000 economic injury loan for his business, which allegedly was a clothing wholesale operation in Los Angeles. The investigation determined that the business was nonexistent.
  - The owner of a Los Angeles, California, clothing company was sentenced to 5 years probation, 1,500 hours of community service, and a \$2,500 fine. He had applied for a \$400,000 economic injury loan.
  - A Los Angeles, California, man was sentenced to 5 years probation, 1,500 hours of community service, and a \$2,500 fine. He had applied for a \$350,000 economic injury loan for his clothing manufacturing business, allegedly located in Los Angeles. The investigation determined that the business was nonexistent.
  - The owner of a wholesale textile company in Los Angeles, California, was sentenced to 5 years probation, 1,500 hours of community service, and a \$2,500 fine. He had applied for a \$300,000 economic injury loan.
  - The owner of a South Gate, California, discount store was sentenced to 5 years probation, 1,500 hours of community service, and a \$2,500 fine. He had applied for a \$210,000 economic injury loan.
  - The owner of a West Los Angeles, California, market was sentenced to 5 years probation, 1,500 hours of community service, and a \$2,500 fine. He had applied for a \$350,000 economic injury loan.
  - The sole proprietor of a rug company in Los Angeles, California, was sentenced to 6 months in a halfway house, 5 years probation, and 1,500 hours of community service. He was also ordered to make restitution to SBA for the \$215,600 total outstanding balance of the loans to his Los Angeles business. In addition to pleading guilty to his own false claim, he also pled guilty to **aiding and abetting the submission of false claims** to SBA by three other loan applicants.
  - A Reseda, California, businessman was sentenced to 5 years probation, 1,500 hours of community service, and a \$2,500 fine. He had applied for a \$500,000 economic injury loan for his business.
- Owners of three other Los Angeles, California, businesses pled guilty to one

count each of filing **false claims** with SBA and were sentenced:

- The owner of a fashion boutique submitted a claim for a \$250,000 economic injury disaster loan and received \$166,900; he submitted a false tax return as part of his loan application package. He was sentenced to 5 years probation, \$166,900 restitution to SBA, 1,500 hours of community service, and a \$2,500 fine.
- The owner of a jewelry store submitted a claim for a \$250,000 economic injury disaster loan; he submitted false tax returns as part of his application package, but the loan was never funded. He was sentenced to 5 years probation, 1,500 hours of community service, and a \$1,000 fine.
- The owner of a textile company submitted a claim for a \$450,000 economic injury disaster loan and received \$51,700; he submitted a false lease agreement as part of his application package. He was sentenced to 5 years probation, 1,500 hours of community service, a \$2,500 fine, and restitution to SBA of \$51,700.

Another defendant who had previously pled guilty to filing a **false claim** with SBA entered a guilty plea to three new charges. The Santa Monica, California, resident pled guilty to three counts of making **false statements in loan applications to Federally-insured financial institutions**. She had

previously entered a guilty plea in connection with her fraudulent application for a \$300,000 economic injury disaster loan. The latest counts charged her with submitting false tax returns to a California savings and loan to obtain a \$716,000 loan and to a California Federal bank to obtain loans of \$1,320,000 and \$1,440,000, respectively.

Yet another Los Angeles businessman was charged with filing a **false claim** with SBA; he subsequently pled guilty. Following the 1992 civil disturbance in Los Angeles, this businessman had applied for a \$126,000 economic injury disaster loan for his (then nonexistent) fashion business and received \$46,900. The investigation showed that, as part of his application, he submitted a false copy of his 1991 tax return reporting income from the bogus business. In fact, the return had never been filed with the IRS, and the SBA loan funds were used to start the business. The businessman's application was prepared by his cousins, the two loan packagers at the center of this investigation.

Finally, one of these two loan packagers has been indicted on 21 counts that supersede the 8 charges already filed against him. In the new indictment, the man was charged with nine counts of making **false statements in loan applications to Federally-insured financial institutions** by submitting false tax returns with applications for four commercial and residential bank loans totaling approximately \$11.4 million. In addition, he was charged with 12 counts of **causing false documents to be submitted to a Government agency by**

assisting others in the submission of false tax returns as part of six SBA disaster business loan applications totaling approximately \$3.95 million. The disaster loan applications included claims of both physical and economic injury and spanned three disasters: the 1992 civil unrest in Los Angeles, the 1993 Malibu fires, and the 1994 Northridge earthquake. Of the 19 individuals who have been charged as a result of this investigation, all but the two brothers have pled guilty. The original investigation of loan packages prepared by the brothers stemmed from a referral from the Disaster Assistance Area 4 Office and a tip from a concerned citizen.

### **Los Angeles Resident Sentenced for False Claim and False Statements in a Loan Application** **Los Angeles Resident Sentenced for False Claim and False Statements in a Loan Application**

A Los Angeles, California, resident was sentenced to 3 years probation, 650 hours of community service, and a \$3,000 fine. In October 1994, he had pled guilty to making a **false claim** to SBA in connection with a disaster home loan application following the Northridge, California, earthquake. After his initial guilty plea, the man furnished false financial documents to the court officer conducting his pre-sentence investigation. As a result, OIG special agents discovered discrepancies that led to an added charge of making a **false statement in a loan application to a Federally-insured financial institution**, to which he pled guilty in April 1995. He had submitted tax returns to a lender using a bogus, second Social Security number which he obtained to disguise a poor credit history. The OIG initiated the investigation based on information provided by the Disaster Assistance Area 4 Office.

**Oregon Shoe Store Owner Sentenced  
for Illegally Converting Loan  
Check**  
**Oregon Shoe Store Owner  
Sentenced for Illegally Converting  
Loan Check**

The owner of a now-defunct shoe store in Burns, Oregon, pled guilty to one count of **illegally converting** an SBA loan disbursement check. He was sentenced to 6 months home detention, 5 years probation, and \$6,100 in restitution to SBA. The man had been approved for a \$71,800 SBA economic injury disaster loan. During the disbursement process, however, SBA discovered that he had failed to list a number of accounts payable, many of which had already been reduced to judgments. The loan was then reduced to the amount already disbursed, \$25,200, and was ultimately charged off as uncollectible. The investigation revealed that the store owner had diverted several of the disbursement checks into accounts other than the business account and that he had not used all of the proceeds as specified in the SBA loan agreement. The OIG initiated the investigation in response to a referral from SBA's Boise District Office.

**California Couple Sentenced for  
Submitting False Claims**  
**California  
Couple Sentenced for Submitting  
False Claims**

A California husband and wife were sentenced for **submitting false claims** in connection with a southern California disaster. Both were sentenced to 3 years probation; they had already paid \$11,256 in restitution to the Federal Emergency Management Agency (FEMA). The SBA/OIG's joint investigation with the FEMA/OIG disclosed that the couple had falsified information on three separate SBA disaster loan applications and on a FEMA application for rental assistance. Each of their disaster home loan applications was declined due to their lack of repayment ability. The SBA/OIG entered this case based on information received from the FEMA/OIG.

**California Loan Applicant Pleads Guilty to Three Felony Counts**  
**California Loan Applicant Pleads Guilty to Three Felony Counts**

A resident of Santa Barbara, California, pled guilty to 3 counts of an 11-count felony indictment: **making a false claim to SBA, misuse of a Social Security number, and making a false statement to a Federally-insured lender.** In return, the Department of Justice agreed to dismissal of the other counts, which included **making a false claim** to FEMA. The applicant claimed to have lost an Isuzu Trooper containing valuable tools in the floods of January 1995. The investigation, which was conducted jointly with the FEMA/OIG, disclosed that the vehicle had been repossessed more than a year before the disaster. The investigation further established that this individual had used five Social Security numbers which were not his, and a variety of spellings of his name, to apply for four loans. The man has remained in custody since his arrest. This matter was referred to the SBA/OIG by the Disaster Assistance Area 4 Office.

**Owner of a California Alarm Company Sentenced for Making False Statements**  
**Owner of a California Alarm Company Sentenced for Making False Statements**

The president and owner of an alarm-device manufacturing business in Canoga Park, California, was sentenced to 5 months in a halfway house and 2 years probation. He had previously pled guilty to **making false statements** to SBA in applying for disaster loans for his business. He had applied for a \$122,925 physical damage loan and a \$112,000 economic injury loan. Both of these loans were declined based on the company's lack of repayment ability and poor credit history. After the company owner submitted additional documents as part of a reconsideration request, the loan processing department of the Disaster Assistance Area 4 Office discovered irregularities with the documents and referred the matter to the OIG. To overcome his unfavorable credit record, the subsequent investigation disclosed that the businessman falsely claimed to have satisfied several debts and judgments. He also falsely represented that the tax returns and extensions he had submitted with his application were authentic copies of the documents submitted to the IRS when they had not been submitted at all.

### **California Restaurant Owner and Loan Preparer Sentenced for False Statement California Restaurant Owner and Loan Preparer Sentenced for False Statement and False Claim**

A restaurant owner who received two SBA disaster loans for her Los Angeles, California, restaurant and an associate who helped prepare the loan application entered guilty pleas--the owner to **making a false statement** to SBA and her associate to **submitting a false claim** to SBA. Subsequently, the owner was sentenced to 3 months home detention, 5 years probation, and 250 hours of community service, and her associate was sentenced to 3 months in a community confinement center, 5 years probation, and 250 hours of community service. The restaurant owner had applied for a \$160,000 physical damage loan and a \$40,000 economic injury loan, claiming that her business was destroyed by a fire caused by the Northridge earthquake. Having discovered irregularities on the Fire Incident Report included as part of the application, the loan processing department of the Disaster Assistance Area 4 Office referred the matter to the OIG. The investigation revealed that the fire which destroyed the restaurant occurred weeks after the date claimed on the loan application and was not caused by the earthquake. The investigation also confirmed that the owner's associate helped prepare the application and altered the Fire Incident Report.

### **Georgia Arena Owner Convicted of Perjury Georgia Arena Owner Convicted of Perjury**

A Federal trial jury convicted the president and major stockholder of a Unadilla, Georgia, horse-show arena on two counts of **perjury**. The charges related to his claims that his signature on a personal guaranty submitted to obtain an economic injury disaster loan was a forgery. In 1992, we reported that, as a result of the OIG's early investigative determination that the signature was not a forgery, SBA had obtained a civil judgment against the man for the principal amount of the loan (\$44,200) plus accrued interest of more than \$8,800. The OIG initiated the investigation, which was conducted jointly with the FBI, based on a referral from SBA's Atlanta District Office.

**Los Angeles County Resident  
Acquitted of Filing False Claim with  
SBA  
Los Angeles County Resident  
Acquitted of Filing False Claim with  
SBA**

A resident of Los Angeles County, California, was convicted of one of the two felony counts on which he had been indicted. The man was convicted of making a **false claim** to FEMA but acquitted of making a **false claim** to SBA. The investigation disclosed that the man falsely claimed to both SBA and FEMA that a residential property he owned in Granada Hills was his primary residence at the time of the Northridge earthquake. His applications for a \$41,600 disaster home loan and an \$11,730 economic injury loan were both declined by SBA due to his lack of repayment ability. The FEMA/OIG and the Postal Inspection Service invited the SBA/OIG into this investigation.

**California Resident Pleads Guilty to  
Theft of Government Funds  
California  
Resident Pleads Guilty to Theft of  
Government Funds**

An Anaheim, California, resident entered a guilty plea to an information charging her with one count of **theft of Government funds**, and in return, the **false claim** indictment against her was dismissed. The woman received funds from FEMA based on her claim to have lived in an apartment where she suffered personal property damage from floods. The investigation revealed, however, that at the time of the floods she occupied a different apartment which did not sustain damage. She was found to have submitted a similar claim to SBA which was rejected by a disaster assistance program official. The SBA/OIG initiated this investigation after being contacted by a concerned private citizen; the investigation was conducted jointly with the FEMA/OIG and the Postal Inspection Service.

### Rhode Island Commercial Lobsterman Sentenced for Mail Fraud Rhode Island Commercial Lobsterman Sentenced for Mail Fraud

A Bristol, Rhode Island, commercial lobsterman was sentenced to 21 months in prison, 3 years probation, \$1,800 in restitution, and a \$150 fine. He had previously pled guilty to three counts of **mail fraud**. The man had received \$55,100 in SBA disaster loan funds to repair his boat and replace lobster traps and other damaged gear. An OIG investigation found that he had submitted financial statements to SBA which overstated the purchase price of the boat, failed to disclose his brother's ownership interest, and masked an outstanding debt on the boat. In addition, the lobsterman had submitted to SBA false receipts for the "destroyed" fishing gear, including a \$32,400 receipt for lobster traps which he never purchased. Finally, he had failed to disclose his prior arrest record to SBA. The OIG initiated the case based on a referral from the Disaster Assistance Area 1 Office.

### Judgment Entered Against Bowling Alley Owner for Disaster Fraud Judgment Entered Against Bowling Alley Owner for Disaster Fraud

A \$133,393 civil judgment for the Government was entered against the owner of a Sellersburg, Indiana, bowling alley who in 1991 had received \$116,500 in SBA disaster assistance for his business. The award included (1) \$26,200 for the man's **false claim** of a \$10,000 account payable resulting from the disaster-related shutdown of his business, and (2) \$107,193 for his **breaches of contract and unjust enrichment** in misusing the proceeds of a \$100,000 loan intended to repair or replace property at the business premises damaged by a tornado and another \$16,500 loan intended to alleviate economic injury caused by the disaster. The unjust enrichment count in the civil complaint related to the businessman's diversion of loan proceeds to his personal use. His June 1993 indictment on one count of making a **false statement** to obtain the disaster loans had previously been dismissed by the court. The OIG initiated the investigation in response to a referral from the Indianapolis District Office.



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## Small Business Investment Companies Small Business Investment Companies

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The primary business of **Small Business Investment Companies** (SBIC) is to provide a source of equity capital and long-term loans to new or expanding small businesses. SBICs are profit-making corporations that make investments in small businesses. SBICs finance small firms in two general ways: (1) straight loans and (2) equity-type investments which give the SBIC actual or potential ownership of a portion of a small business' equity securities. Many SBICs also provide management assistance to the companies they finance.

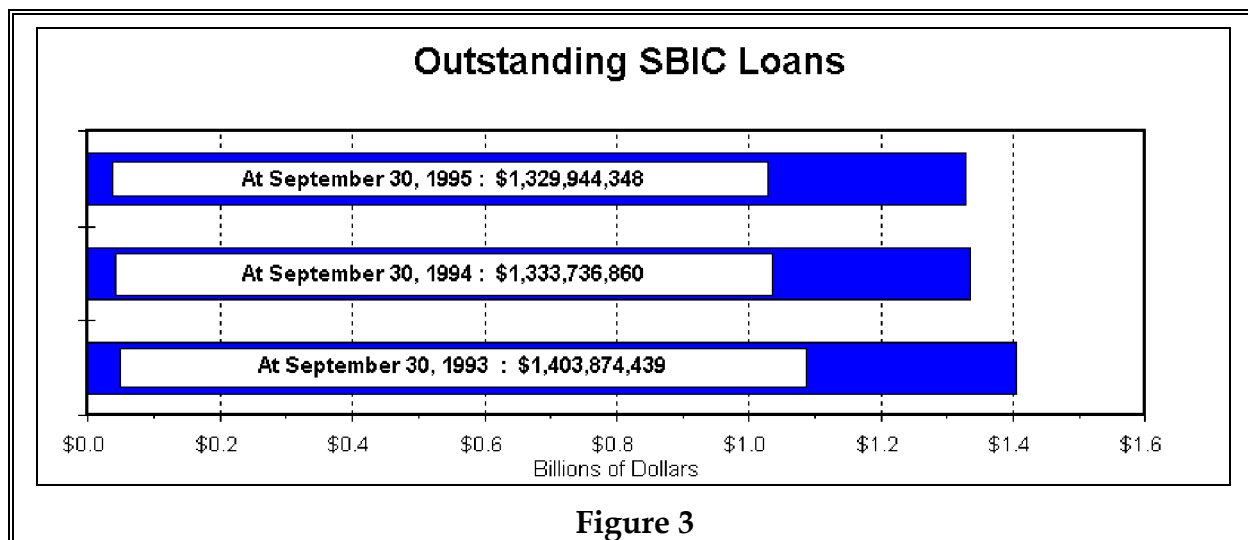
SBA licenses, regulates, and provides financial assistance to SBICs, which are privately owned, operated, and capitalized. The Small Business Investment Act (SBI Act), as amended, authorizes SBA to purchase or to guarantee the timely payment of all scheduled interest and principal on debentures issued by such companies. Under Section 301(d) of the SBI Act, SBA also licenses Specialized SBICs (SSBIC) to help those small businesses owned and managed by socially or economically disadvantaged persons. As of the end of FY 1995, there were 275 licensed, active SBICs, including SSBICs, with leverage funds of over \$1.02 billion and combined private capital of almost \$3.5 billion. In addition, there were 190 SBICs in liquidation owing SBA over \$506 million. In FY 1995, the program level for investment companies, including participating securities, was \$355.4 million.

The SBI Act generally requires that all SBICs licensed by SBA be examined once every 2 years to ensure licensee compliance with law and Agency regulations. The Small Business Credit and Business Enhancement Opportunity Act of 1992 transferred the responsibility for examining SBICs to the Agency effective October 1, 1992. The SBA's Investment Division is now responsible for these examinations; the OIG, however, continues to have authority to audit aspects of the SBIC program pursuant to its responsibility to oversee all Agency programs and activities.

### Summary of OIG Activity

The following summarizes OIG activities relating to the SBIC program during the reporting period:

- SBIC investigations resulted in one indictment and one conviction.
- SBIC investigations produced \$1,457,434 in recoveries by



SBA and a \$250,000 civil penalty.

- Three SBIC investigations were closed, leaving an inventory of 16 active cases. Due to workload demands, an additional SBIC case was referred to another law enforcement agency for investigation. It is the only SBIC referral for the OIG to monitor for performance.
- Two SOPs were reviewed.

### **Efforts to Improve SBA Program Management**

## **Review of Draft SBIC Regulations**

The OIG reviewed an SBA working group's comprehensive revision of 13 C.F.R. Part 107, the regulation governing the SBIC program, and had several comments. First, the draft regulation provides that one of the tests for determining whether an SBIC is "active" is whether, during the 18 months preceding the SBIC's most recent fiscal year end, the SBIC made financings (excluding commitments) totaling at least 20 percent of its regulatory capital. This test would not, however, cover a situation where, for example, an SBIC made financings totaling 90 percent of its regulatory capital 2 years ago and is holding those investments for the statutory 5-year period. In our opinion, an SBIC in such a situation should be considered "active," for the bulk of its funds are tied up in investments and it has no more funding to invest. Second, we disagreed with the revised wording of subsection (e), requiring SBICs to file financial statements with SBA, because it appears to exclude licensee reporting on the economic impact of financings in such areas as technology development or commercialization, minority business development, urban or rural business development, and expansion of exports. When reporting on program results to Congress or other interested parties, we believe it would be beneficial for SBA to be able to reflect these positive outcomes, in addition to tax revenue and jobs created. The OIG agreed, however, that the reporting of assistance to manufacturing firms may be unnecessary.

Third, the draft regulation would require SBICs that do not meet the 10 percent dollar threshold of Smaller Business investments to finance only Smaller Businesses until the 10 percent dollar threshold is met. We are concerned that this remedy may force SBICs to make inappropriate investments in Smaller Businesses that they would not be willing to make otherwise, potentially putting Government dollars at unnecessary risk, or it may result in SBICs passing up otherwise viable investments in Small Businesses. A preferred remedy may be to require the SBIC to meet the 10 percent threshold within one fiscal year of the year of noncompliance, which would give the SBIC reasonable time to invest in viable Smaller Businesses.

Finally, we noted that the prohibition with regard to "project financing" appears to relate to high-risk ventures, e.g., making a motion picture or drilling for oil or gas, that are not deemed appropriate for SBIC financings. The actual language of the draft regulation, however, is vague and unclear and technically could apply to any business that sells its inventory as its primary revenue source. The OIG therefore suggested clarifying the regulation's language to more specifically describe the types of businesses to be covered.

### **Activities to Enhance Fraud Detection and Deterrence**

**Consent Judgment Entered Against  
Canadian Financier  
Consent Judgment Entered Against  
Canadian Financier**

A consent judgment was entered against a Canadian national, requiring him to pay a \$250,000 civil penalty to the Government for **corruptly giving something of value to an agent of a financial institution**. This settlement was a result of the SBA/OIG's investigation of an SSBIC in Jacksonville, Florida, conducted jointly with the FBI, the OIG of the Resolution Trust Corporation, and the Criminal Investigation Division of the IRS. The investigation disclosed that the SSBIC's owner had secretly sold the SSBIC to a second Canadian national, while agreeing to "front" for him in dealings with SBA. Knowing the illegal purpose to which the new "owner" was going to put it, the first Canadian national had provided the second one with money to purchase the SSBIC. This action brings recoveries and savings in this case to approximately \$2.8 million. The OIG joined this investigation at the request of the FBI.

**Specialized SBIC President  
Sentenced  
Specialized SBIC President  
Sentenced for Participating in a  
Borrower's Loan Proceeds**

The president of an SSBIC in Houston, Texas, was sentenced to 1 day imprisonment, 5 years supervised release, and repayment of SBA losses, currently calculated at \$3,567,296. He had pled guilty to an information charging him with **unlawfully participating in the proceeds** of a \$308,151 loan made by the licensee to a small business concern. The SSBIC principal, a Chinese national, had told the court that he used the money to pay a divorce settlement he owed his ex-wife. The OIG's joint investigation with the FBI was based on a referral from the OIG's Auditing Division.



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## Surety Bond Guarantees Surety Bond Guarantees

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Small and emerging contractors who cannot get surety bonds through regular commercial channels can apply for SBA bonding assistance under the **Surety Bond Guarantee Program**. Under this program, SBA guarantees a portion of the losses sustained by a surety company as a result of the issuance of a bid, payment, and/or performance bond to a small business concern.

Businesses in the construction and service industries can meet the SBA's size eligibility standards if their average annual receipts (including those of their affiliates) for the last 3 fiscal years do not exceed \$5 million. Any contract bond is eligible for SBA guarantee if the bond is covered by the Contract Bonds section of the Surety Association of America Rating Manual, required by the invitation to bid or by the contract, and executed by a surety company that is determined by SBA to be eligible to participate in the program and certified acceptable by the U.S. Treasury.

The **Preferred Surety Bond (PSB)** program allows selected sureties to issue, monitor, and service surety bonds without SBA's prior approval. SBA accomplishes two primary objectives through this program: (1) expanding the number of sureties participating in the surety bond guarantee program, and (2) increasing bonding availability to business concerns that would otherwise not be able to obtain bonding in the standard marketplace. Title II of Public Law 100-590 also requires an annual review of each surety participating in this program.

SBA can guarantee bonds for contracts with a face value of up to \$1.25 million. In FY 1995, SBA contingent liability for new final bond guarantees, including those issued under the PSB program, was \$1.220 billion. The appropriated credit level for FY 1995 surety bond guarantees was \$1.767 billion.

### Summary of OIG Activity

The following summarizes OIG activities relating to SBA's surety bond guarantee program during the reporting period:

- One program inspection report was

issued.

- Office of Security Operations name checks resulted in the declination of three surety bonds.
- One surety bond investigation remained active at the end of the

reporting period.

- One surety bond investigation continued to be monitored. Due to workload constraints, it had previously been referred to another law enforcement agency for investigation.
- One piece of proposed legislation was reviewed.

## **Efforts to Improve SBA Program Management**

### **Improvements Needed in Managing Surety Bond Guarantees**

An OIG inspection examined three aspects of the Surety Bond Guarantee Program: (1) the extent to which contractors from the Prior Approval (Plan A) and Preferred (Plan B) programs graduate, i.e., become bondable on their own without the SBA guarantee; (2) the reasonableness of SBA's losses on its guaranteed bonds; and (3) recoveries on SBA surety bonds, in comparison with non-SBA surety bonds.

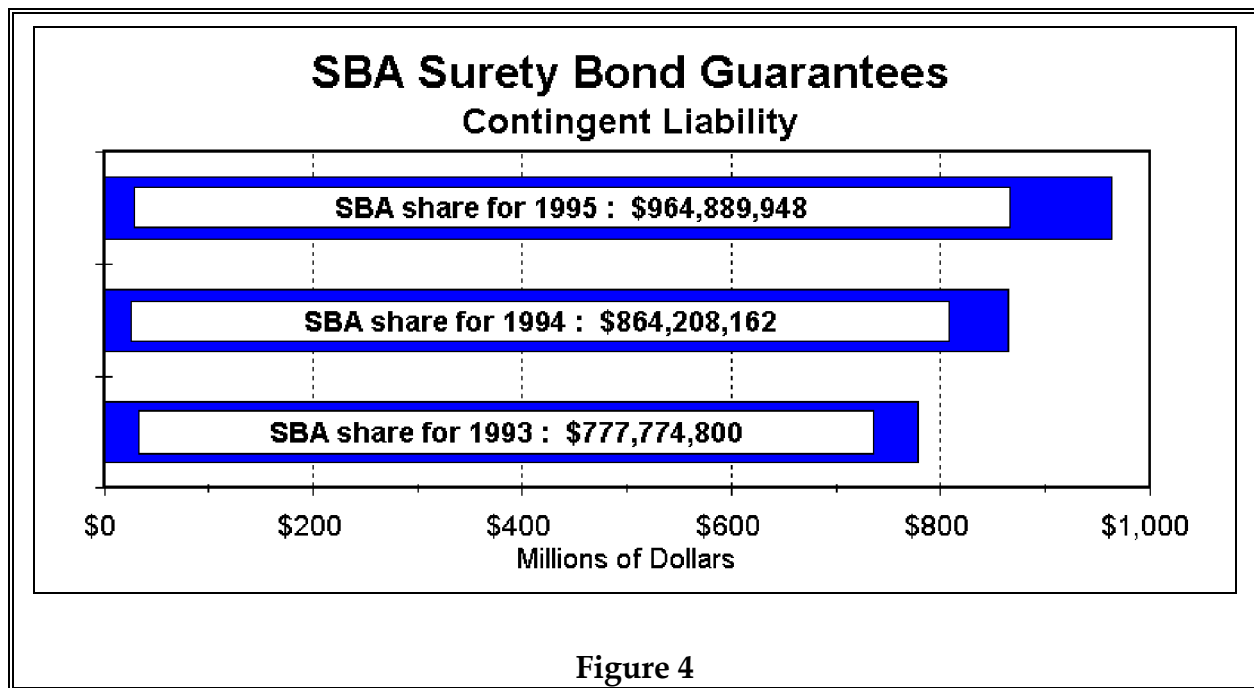
The OIG inspectors found that the program's goal of assisting contractors to become bondable on their own was not being met in many cases. At the Plan A surety companies reviewed, for example, fewer than eight percent of the contractors who received their first SBA-guaranteed bond had graduated from the program. The OIG recommended that SBA establish target graduation rates, require participating surety companies to keep records on contractors' graduation, and disseminate a brief handout for

contractors that emphasizes graduation as a program objective and identifies the types and sources of available technical assistance.

The inspectors also found that the program's loss rates on Plan A bonds were nearly three times those of the surety industry when calculated using the industry method. Despite these large loss rates, the surety companies earned profits on SBA bonds comparable to those earned on standard bonds, due to SBA's guaranteed reimbursement of up to 90 percent of losses. To reduce loss rates, the OIG recommended that SBA propose legislation, in consultation with Congress and the surety industry, for a modest reduction in the guarantee percentages on Plan A surety bonds. This would provide needed incentive for surety companies to minimize losses on SBA-guaranteed bonds.

Finally, the OIG's comparison of recovery rates on SBA and non-SBA bonds was inconclusive due to the difficulty of obtaining reliable data. To enable SBA to better evaluate whether participating surety companies are pursuing recoveries prudently, the OIG recommended that SBA require the companies to produce reliable recovery data on their SBA bonds.

In cases where a surety company offers both SBA and non-SBA bonds, we recommended that SBA periodically request both sets of data for comparison. Such reporting would provide incentive for the surety firms to maximize SBA recoveries.



The Office of Surety Guarantees (OSG) disagrees with two of the five recommendations. It believes that target graduation rates are unnecessary and that reducing the guarantee percentage would prompt the surety industry to decline to bond needy contractors.

In a subsequent meeting, the SBA Administrator directed the OSG to work with the OIG to identify reasonable performance measures for evaluating and managing this important SBA program.

## **Review of SBA Legislative Proposal Review of SBA Legislative Proposal**

The OIG also reviewed an SBA legislative proposal that would make the Preferred Surety Bond (PSB) program permanent and would increase the amount of surety guarantee budget authority available for the program in FY 1996. While we did not object to these proposals, we requested that the OIG's proposal concerning the PSB program also be incorporated in the package. Briefly, this would amend Section 411(g)(3) of the Small Business Investment Act to replace the present requirement for an annual audit of participating sureties with a requirement for an annual **review**. This would relieve the OIG of the requirement to conduct such audits while allowing the Office of Surety Guarantees to conduct appropriate management reviews commensurate with the level of activity and risk posed by each surety. The OIG would, however, retain its authority under the Inspector General Act to perform formal audits of participating sureties on its own initiative or in response to requests from program officials. The expected result of these proposed changes would be better utilization of limited OIG audit resources, as well as more effective annual review of participating sureties' activities. If enacted, this proposal would enable both the OIG and the program office to concentrate on those sureties with the most activity and/or risk.

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## Government Contracting Programs Government Contracting Programs

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SBA provides assistance to small businesses in obtaining a fair share of Federal Government contracting opportunities. The SBA also works with each department or agency to establish procurement goals for contracting with small, small-disadvantaged, and women-owned businesses. The Agency's government contracting programs include **Prime Contracts**, **Subcontracting Assistance**, **Certificate of Competency**, **Natural Resources Sales Assistance**, and the **Procurement Automated Source System**.

The goals of the **Prime Contract Programs** are to increase small business opportunities in the Federal acquisition process and to expand full and open competition to effect savings to the Federal Government. Supporting initiatives are carried out by traditional and breakout procurement center representatives assigned to major Federal acquisition activities.

The **Subcontracting Assistance Program** promotes the optimal utilization of small businesses by the Nation's major prime contractors. This is carried out by commercial market representatives who monitor the procurement activities of the large prime contractors.

The **Certificate of Competency (COC) Program** provides an appeal process to assure that small business concerns, especially those new to the Federal procurement market, are given a fair opportunity to compete for and win Government contracts. If a small business is the successful offeror on a contract but is found non-responsible, it can appeal to SBA. After reviewing a firm's capabilities, SBA can issue a COC that requires the contracting officer to award the contract to that business.

**Natural Resources Sales Assistance** helps small businesses obtain a fair share of Federal property offered for sale or disposal, with a focus on sales of Federal timber, royalty oil, coal leases, and other mineral leases.

The **Procurement Automated Source System (PASS)** is the SBA's computerized inventory of U.S. small businesses that are interested in Federal procurement opportunities, either directly with the Government or with prime contractors. Both Federal agencies and large prime contractors use PASS as a resource in identifying small businesses for procurement opportunities.

## **Summary of OIG Activity**

The following summarizes OIG activities relating to SBA's Government contracting programs during the reporting period:

- One draft inspection report was issued.
- No Government contracting investigation was closed; seven were active.
- One Government contracting investigation continued to be monitored. Due to workload constraints, it had previously been referred to another law enforcement agency for investigation.

## **Efforts to Improve SBA Program Management**

## **Coping with Major Downsizing in the Prime Contracts and Subcontracting Programs**

In August, the OIG's Inspection and Evaluation Division provided a draft report on the prime contracts and subcontracting programs to the Office of Government Contracting. During the inspection, SBA began to downsize and reorganize the programs significantly. Accordingly, we made recommendations for improving program oversight, performance incentives, deployment, data base support, internal coordination, and field reporting. At the close of the reporting period, we were awaiting the response of the Assistant Administrator for Government Contracting.

## **Activities to Enhance Fraud Detection and Deterrence**

### **Listing of Companies Ineligible to Self-Certify as Small Recommended Listing of Companies Ineligible to Self-Certify as Small Recommended**

Over the past few years, the Investigations Division has noted several instances of a particular fraudulent practice: companies that SBA, after sustaining protests against them, had prohibited from representing themselves as small businesses, under a particular SIC code, were continuing to falsely certify themselves as eligible for small business set-aside contracts. Because contracting agencies had no simple way of knowing whether SBA had found a company too large for set-aside contracts under a particular SIC code, they were sometimes awarding contracts to ineligible businesses by relying on false certifications. To prevent such awards, the Inspector General issued a program vulnerability memo suggesting to the Deputy Administrator, in her capacity as chairperson of SBA's Size Policy Board, that the Agency periodically generate a list of companies found ineligible to self-certify as small for contracts under specified SIC codes and circulate it to all Federal agencies for their use.

The Assistant Administrator for Government Contracting, responding for the Deputy Administrator, responded that, while the suggestion had merit, its risks outweighed the benefits. With the stringent time deadlines of the size determination process potentially

producing frequent appeals and reversals, with novice contracting officers possibly confusing SIC codes, and with resource constraints limiting the frequency of SBA's production of the list, agencies would often be ruling out contractors who are in fact eligible for the procurements at issue.



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## Minority Enterprise Development Minority Enterprise Development

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**Section 7(i)(10)** of the Small Business Act established the **Minority Small Business and Capital Ownership Development Program** for the purpose of promoting greater access to the free enterprise system for socially and economically disadvantaged individuals. Under the Act, SBA provides business development assistance to small business concerns that are at least 51 percent unconditionally owned, controlled, and managed by one or more socially and economically disadvantaged individuals, and that meet other eligibility requirements. Firms may participate in the program for a maximum of 9 years and must take steps to enhance their competitiveness during this period, to be prepared to compete in the private sector upon graduation from the program.

One of the business development tools available to participant firms is access to Federal contracting opportunities authorized by **Section 8(a)** of the Small Business Act. Under the Section 8(a) program, SBA contracts with other Government agencies to provide goods and services, and subcontracts the performance of these contracts to program participants. As of September 30, 1995, there were more than 5,400 approved program participants. In FY 1995, Section 8(a) program participants received over 6,056 contracts with an aggregate value in excess of \$4.4 billion. Generally, Section 8(a) contracts with estimated values, including all options, of more than \$5 million (manufacturing) or \$3 million (all other industries) must be competed among eligible Section 8(a) program participants. The vast majority of the contracts awarded under the program, however, have estimated values below these thresholds and are awarded on a sole-source basis.

Under the **Section 7(i) Management and Technical Assistance Program**, which is housed in the Office of Minority Enterprise Development, SBA funds services by private or public organizations to provide a broad range of management and technical assistance to certified Section 8(a) firms, socially and economically disadvantaged individuals whose firms are not participants in the Section 8(a) program, low-income individuals, and small businesses located in areas of low income or high unemployment. The Section 7(i) program uses cooperative agreements with private sector organizations and institutions of higher learning to deliver assistance in three categories: (1) **Task Order Services** are used to provide one-on-one assistance to eligible companies in accounting, marketing, and industry-specific services; this is the largest Section 7(i) assistance category.



(2) On-going Services provide seminars and workshops in management and technical assistance. (3) The Minority Business Executive Program provides executive development training opportunities in an academic setting to selected executives of Section 8(a) companies.

There are over \$9 billion in Section 8(a) subcontracts currently outstanding and subject to OIG audit, inspection, and investigation. These contracts are reflected in other Government agencies' portfolios and, therefore, their values are not included in our \$26 billion audit, inspection, and investigation universe.

### **Summary of OIG Activity**

The following summarizes OIG activities relating to SBA's minority enterprise development programs during the reporting period:

- Two audits were issued in this program area; six audits were in progress.
- Minority enterprise development investigations resulted in two indictments and one conviction.
- Minority enterprise development investigations produced \$365,766 in restitution to procuring agencies and other third parties.
- Office of Security Operations name checks resulted in the declination of 11 applications for the Section 8(a) program.

- Eleven minority enterprise development investigations were closed, leaving an inventory of 21 active cases. Due to workload demands, another eight minority enterprise development cases were referred to other law enforcement agencies for investigation, and at the end of the reporting period we still had six minority enterprise development referrals to monitor.
- One proposed regulation and one SOP were reviewed.

### **Efforts to Improve SBA Program Management**

**SBA Efforts to Enforce Section 8(a) Competitive Mix Requirements Have Not Always Been Effective**  
**SBA Efforts to Enforce Section 8(a) Competitive Mix Requirements Have Not Always Been Effective**

SBA is not always effectively implementing the competitive mix requirements of the Section 8(a) program. According to an OIG audit report, business opportunity specialists took minimal or no action when companies reported that their non-8(a) sales ratio was lower than the targets established in the regulations. Companies not complying with the targets received \$1.4 billion in Section 8(a) contracts in their latest year, according to SBA's database in February 1995. This was two-thirds of the total Section 8(a) sales by 1,000 companies who had Section 8(a) sales and were subject to the competitive mix targets as of their last reporting date.

The Business Opportunity Development Reform Act of 1988 required that Section 8(a) companies develop significant levels of non-8(a) business to prepare for competitive success after graduation, rather than becoming dependent on sole source contracts. Implementing regulations issued by SBA established targets for non-8(a) sales, rising from a minimum of 15 percent in the fifth year of program participation to 55 percent by the ninth year (graduation). In the February 1995 list, **many firms receiving millions of dollars of Section 8(a) sole source awards had insignificant levels of non-8(a) business.**

The OIG auditors found that SBA did not

often use the strict measures available in the regulations. Although SBA regulations identified a range of actions including denial of further sole source contracts or even termination, SBA program managers generally chose "remedial action plans" if there was any response at all to non-complying business mix. The remedial action plans, however, usually had little or no impact on the level of Section 8(a) contracts the companies could still receive.

In addition, SBA had not established a tracking system to gauge the impact of the competitive mix requirement on Section 8(a) firms' ability to stay in business after leaving the Section 8(a) program. SBA could not, therefore, measure the success of the Section 8(a) program as required by Congress in the 1988 act, i.e., data was not available to correlate compliance with competitive mix requirements. Hence, the Agency is unable to track a company's continuing success after Section 8(a) contracts are no longer available.

The audit recommended that SBA (1) set mandatory dollar limits on Section 8(a) awards to firms not complying with competitive mix, and (2) establish procedures to evaluate post-graduation success in relation to competitive mix. The Associate Administrator for Minority Enterprise Development concurred with the recommendations.

**Section 8(a) Owner Distorts Net Worth; Withdraws from Program**

The owner of a Section 8(a) firm, who gave SBA inaccurate financial statements, exceeded the program's net worth limit and withdrew from the program after an audit that was requested by the Washington District Office. The District Office requested the audit after noting that the owner withdrew millions of dollars from the company from 1988 to 1993, including over half of that sum in the last 2 years alone, but reported a net worth of only one eighth of the total cash he withdrew.

The owner was uncooperative with the auditors, thereby forcing the issuance of an IG subpoena for the company's records. The auditors also used records of financial institutions to complete the audit. The audit report demonstrated that the owner's 1994 net worth for Section 8(a) eligibility was well above the \$750,000 limit for continued participation in the program. The owner had understated his assets in cash, stocks, real estate, and retirement plans, while overstating the balance on a mortgage.

The Section 8(a) company owner stated that he was unaware of the net worth requirements for the Section 8(a) program, although he certified to SBA that he had read the pertinent regulations. The owner voluntarily withdrew from the program in September 1995.

**Review of Business Activity Targets**

The OIG reviewed a proposed revision to 13 C.F.R. Part 124 concerning the computation and effect of non-8(a) business activity targets. While we agreed that SBA must take some action to help program participants attain their non-8(a) business activity targets, we objected to the proposed rule because our analysis indicated that adopting the 4-step formula would not ensure that Section 8(a) firms meet the competitive mix requirements.

As an alternative, we proposed that companies not meeting their competitive mix targets be limited to the level of Section 8(a) sales that are supported by their non-8(a) sales. For example, a company with \$1 million in non-8(a) sales and a target of 25 percent would be allowed \$3 million in Section 8(a) sales the following year. This proposal would bring Section 8(a) companies into compliance immediately and would keep Section 8(a) contracts from going to companies who are not meeting the statutory business development requirements. The Section 8(a) sales limit could be increased whenever a company documents an increase in non-8(a) sales.

**Review of General Services  
Administration (GSA) Policy on  
Information Technology  
Review of  
General Services Administration  
(GSA) Policy on Information  
Technology**

The OIG reviewed a proposed GSA notice, "Interagency Sharing of Indefinite Delivery/Indefinite Quantity Contracts for Information Technology," and expressed our strong opposition to the proposal. We recommended that GSA specifically exclude Section 8(a) sole source indefinite delivery/indefinite quantity (IDIQ) contracts from this proposed notice. The proposal would change existing GSA policy and allow agencies to open up, for use by other agencies, all existing IDIQ contracts for information technology products and services to a maximum of 20 percent of the total contract amount. If adopted, this policy would effectively circumvent current SBA regulations governing the Section 8(a) program, which cap sole source 8(a) procurements at \$5 million for procurements with manufacturing SIC codes and \$3 million for all other procurements.

The proposed policy would also exacerbate problems that SBA has attempted to resolve through a recent change in the method used to determine the value of Section 8(a) IDIQ procurements for sole source purposes. Prior to August 7, 1995, the value of IDIQ procurements for sole source purposes was the guaranteed minimum value of the procurement, rather than the total anticipated award price. As such, the actual value of various sole source Section

8(a) IDIQ contracts is many times greater than the sole source cap. Unless GSA exempts sole source Section 8(a) contracts from its proposed new policy, this proposal would allow both current and former Section 8(a) companies that had received these original large contracts to receive up to 20 percent more of the contracts' value in amendments.

**Activities to Enhance Fraud  
Detection and Deterrence**

**Maryland Computer Company Owner Indicted for Fraud**  
**Maryland Computer Company Owner Indicted for Fraud**

The president and owner of a computer support contractor in Landover, Maryland, was indicted on seven counts of **false statements, misuse of a Social Security number, wire fraud, and bank fraud.** To obtain the company's admission to the Section 8(a) program, the owner had concealed two prior bankruptcy proceedings from SBA, used five false Social Security numbers, and submitted to SBA personal and corporate tax returns which had not been filed with the IRS. She also billed inflated indirect costs on a BATF Section 8(a) contract and diverted the extra funds to her own use; converted to her own use monies withheld from the employees' paychecks for income, Social Security, unemployment, and disability taxes; and submitted false and forged documents to two Federally-insured banks to obtain loans for the purchase and construction of real estate. Following a referral from SBA's Washington District Office (WDO), the SBA/OIG joined the Treasury/OIG's ongoing investigation of the company. The Health and Human Services/OIG and the IRS are also participating. The WDO has recommended termination of the company from the Section 8(a) program and, in conjunction with BATF, denied the company \$9 million in Section 8(a) contract options.

[Editor's note: The Office of Minority Enterprise Development terminated the company from Section 8(a) program participation, effective October 29, 1995.]

**Pennsylvania Section 8(a) Company Officer Sentenced for Fraud**  
**Pennsylvania Section 8(a) Company Officer Sentenced for Fraud**

The vice president of a former Section 8(a) contractor in Ardmore, Pennsylvania, pled guilty to two counts of **mail fraud.** To obtain loans totaling \$321,033, he had submitted to two lending institutions modification orders which he had altered to inflate their value as collateral on contracts at the Philadelphia Naval Shipyards. The businessman was sentenced to 1 year incarceration, 3 years supervised release, and \$134,000 in restitution to the two lenders, one of which referred the matter to the OIG. The investigation was conducted jointly with the Naval Criminal Investigative Service.

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## Economic DevelopmentEconomic Development

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SBA provides assistance to small business owners, managers, and prospective owners through its many counseling and training programs. SBA established the **Small Business Development Center (SBDC)** program to make management assistance and counseling widely available. SBDCs offer one-stop assistance to small businesses by providing a wide variety of information and guidance in easily accessible locations. The program is a cooperative effort by the private sector; the educational community; and Federal, State, and local governments. There are SBDCs in all 50 states, the District of Columbia, Puerto Rico, the Virgin Islands, and Guam, with over 950 subcenters or service locations located at colleges, universities, vocational schools, chambers of commerce, economic development corporations, or downtown storefronts.

The **Small Business Institute (SBI)** program gives small business owners an opportunity to receive intensive management counseling from qualified undergraduate and graduate college business students working under faculty guidance. Established in 1972, the SBI program provides help to approximately 6,000 businesses each year. SBI counseling focuses on the full range of management problems which may be encountered by a small business; the program's emphasis is on practical, realistic, and affordable solutions.

The **Service Corps of Retired Executives (SCORE)** is another of the valuable business development resource partners of SBA. Composed of approximately 13,000 volunteers working in over 700 sites, SCORE provides counseling and training to current or prospective business persons. Counseling sessions are free to the public and training is provided at a low cost.

The vast majority of SBA business development and education activities in the areas of training, counseling, and providing management information materials occur through outreach efforts with external organizations. **Cosponsorship** arrangements, authorized under the Small Business Act, play a key part in this process. The Act gives SBA the authority to cosponsor training and counseling activities for small business concerns with non-profit entities and/or with other Federal Government agencies. In addition, the Act authorizes the Agency to cosponsor training, but not counseling, with for-profit concerns.

**Business Information Centers (BICs)** provide business owners with access to computers, software, databases, and other resources to assist them in starting and expanding their businesses. All BICs have at least one on-site counsellor and can address the varied business start-up and growth issues encountered by small business owners. In FY 1994, SBA had 12 BICs, and by the end of FY 1995, 25 BICs were in operation.

### **Summary of OIG Activity**

The following summarizes OIG activities relating to SBA's economic development programs during the reporting period:

- Two audit reports were issued in the economic development program area; a third was in progress.
- One economic development investigation was opened; it was active at the end of the reporting period.
- One economic development investigation continued to be monitored. Due to workload constraints, it had previously been referred to another law enforcement agency for investigation.
- One proposed regulation and two SOPs were reviewed.

### **Efforts to Improve SBA Program Management**

**Audit Finds Non-Compliance with Grant Rules at a Puerto Rico Small Business Development Center**  
**Non-Compliance with Grant Rules at a Puerto Rico Small Business Development Center and Agency Monitoring in Need of Improvement**

administrative support positions. In addition, there was no documentation on site visits nor any evaluation of fees charged to clients. The SBA District Director also concurred with these findings and initiated corrective actions.

The OIG issued a report on the Puerto Rico Small Business Development Center (SBDC) which included 3 findings and 15 recommendations to improve the operations of the SBDC. During the audit, the OIG found the SBDC: (1) provided **minimal amounts of counseling** assistance to clients and directed a majority of resources toward administrative functions rather than counseling, (2) provided **insufficient cash match funds** for the SBA grant and was not in conformance with various program requirements, and (3) expended grant funds for **excessive compensation** to SBDC and University officials and overseas travel unrelated to the SBA grant. Agency officials agreed with the findings, and the SBDC will be required to reimburse SBA for the insufficient cash match and unallowable expenditures of grant funds.

A follow-up audit initiated based on the findings reported above, revealed that Agency monitoring was in need of improvement. The SBA project officer did not analyze reports submitted by the SBDC and, consequently, several deficiencies were not detected. Deficiencies included **cash match shortages, minimal counseling hours, and ineffective use of resources**, i.e., nearly 60 percent of the SBDC's employees were occupying



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## Agency Management and Financial Activities Agency Management and Financial Activities

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Agency **Management and Financial Activities** include SBA's administration of the loan programs, as well as the full range of internal administration and financial management operations. OIG audit, investigative, and inspection activities assist SBA managers by reviewing these operations and by conducting audits of Agency financial statements as required by the Chief Financial Officers Act, audits of cash management activities, and integrity assurance activities.

SBA's management and financial activities, represented by the Agency's total appropriation, involved almost \$1.893 billion in FY 1994. The SBA's FY 1995 actual appropriation used was \$821.8 million\*, including Section 7(a) and disaster carryover funds and released disaster contingency funds. FY 1995 budget authority, including contingency funds, is \$1.062 billion.

\* The sharp decline in FY 1995 from FY 1994 levels is attributable to the extraordinary cost of the 1994 Northridge earthquake.

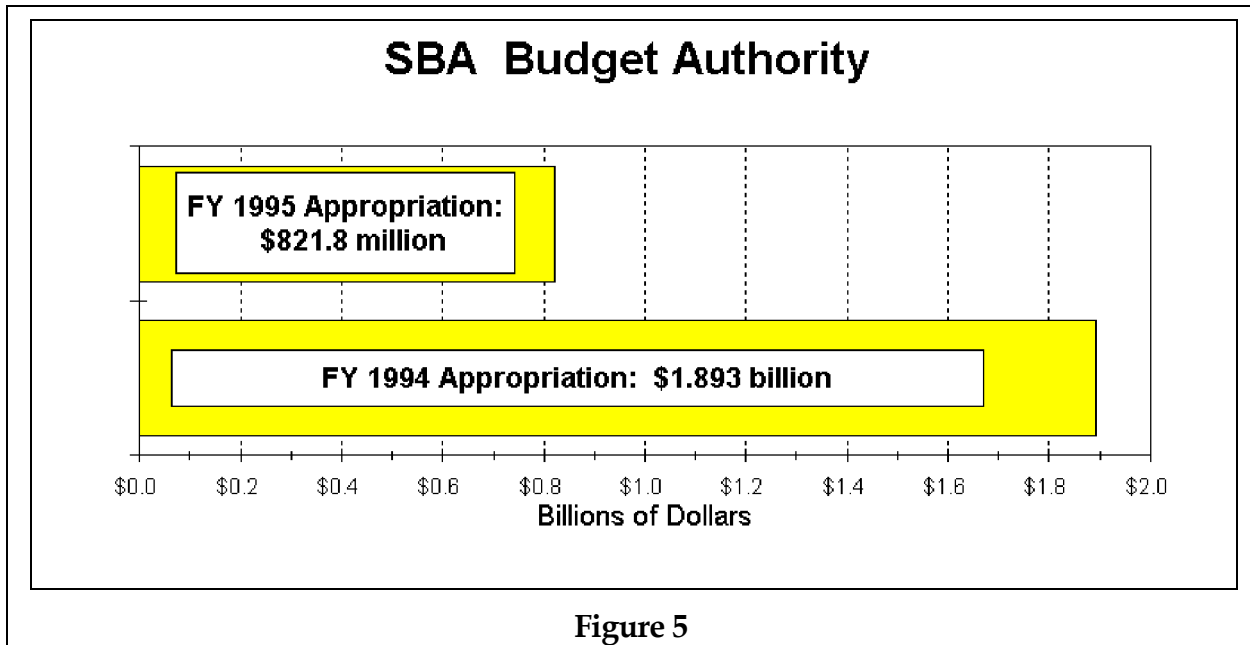
### Summary of OIG Activity

The following summarizes OIG activities relating to SBA's administration and financial management activities during the reporting period:

- Five audits of Agency activities were issued; one other audit was underway.
- Integrity assurance investigations resulted in two indictments and two convictions.
- Seventeen integrity assurance

investigations were closed, leaving an inventory of 20 active cases.

- Two integrity assurance investigations continued to be monitored. Due to workload constraints, they had previously been referred to other law enforcement agencies for investigation.
- We reviewed 1 proposed piece of legislation for Agency



management and financial activities, 19 regulations, and 3 SOPs.

- The Inspection and Evaluation Division issued one report on behalf of the PCIE.

### Efforts to Improve SBA Program Management

#### Auditors Qualify Opinion on 1994 SBA Financial Statements Auditors Qualify Opinion on 1994 SBA Financial Statements

The annual audit of SBA's FY 1994 financial statements resulted in a qualified opinion for the fourth straight year because of property inventory and valuation questions. The OIG-contracted Independent Auditor's Report stated that SBA did not maintain comprehensive

inventory records of acquired property and did not consistently value the acquired property at its net realizable value. The statements valued acquired property at \$148 million. Except for these two recurring issues, the audit found that the Agency's financial statements were presented fairly. In a separate report on management issues, there were nine findings related to general ledger and reporting procedures, electronic data processing internal controls, and other compliance matters.

#### General Ledger and Reporting

- Cash was not being reconciled to the U.S. Treasury balances during 1994. Manual reconciliations were postponed while an automated system was under development (a repeat finding from 1993 management letter).

- Accruals for estimated losses in the Surety Bond Guarantee Program only include losses for the following year instead of all future losses (a repeat finding).
- Year-end closing procedures for acquired property are still inaccurate, with \$35 million of 1994 transactions recorded in 1995 (a repeat finding).

#### Electronic Data Processing Controls

- Off-line general ledger systems lack segregation of duties because system designers, operators and users can all access transactions. There is also inadequate documentation for transactions.
- A new automated procedure for the Standard Form 224 report to Treasury also lacks segregation of duties.
- Local Area Network (LAN)-based personal computer systems have replaced mainframe terminals in the Office of the Comptroller, creating a need for electronic Data processing security reviews that have not been implemented.

#### Other Compliance Matters

- Some provisions of OMB Circular A-129 cited in the 1993 report were still not implemented:
  - Lenders should be required to suspend loan processing

if an applicant is delinquent on other Federal debt.

- Collateral over \$100,000 should be valued by a certified real estate appraiser.
- Lenders should be held to a reasonable due diligence standard as a precondition for making a claim to SBA for payment of a loan guarantee.

- File room security in the Small Business Investment Company program office was inadequate (a repeat finding from 1993).
- Annual subsidy re-estimates under the Federal Credit Reform Act of 1990 were not being done as required by OMB Circular A-34. Until recently, SBA lacked a mechanism for calculating the amounts.

**Grant Violations Uncovered at a Pennsylvania College Women's Program**  
**Grant Violations Uncovered at a Pennsylvania College Women's Program**

An audit of an SBA grant to an education center for women in business at a Pennsylvania college questioned \$319,742 in costs and identified **numerous violations of SBA grant requirements**. The center had received \$1.9 million in special grants to assist current and potential women entrepreneurs. This was a final audit of the initial \$1 million grant and an interim audit of a \$930,000 continuation grant. The largest category of cost questioned was \$114,083 for a billing error of first year estimated expenditures that were not incurred. The college reimbursed SBA \$85,963 of the billing error and SBA management agreed to obtain a commitment from the college to pay the \$28,120 balance. The college also charged an inequitable share of the cost of a local area network. SBA management agreed that \$96,367 of the cost was not allocable to the grant. This report was reissued after evaluating additional information submitted by the college after an initial audit report was issued.

**Salaries and Other Costs Questioned at Genome Research Center**  
**Salaries and Other Costs Questioned at Genome Research Center**

An audit of a New Mexico-based genome research center questioned \$147,000 in salaries and other costs out of \$1.4 million expended over a 20-month period.

SBA has awarded the Santa Fe, New Mexico-based center \$8 million in special appropriated funds to establish a genome research database. An interim report in June 1995 stated that the project was not fulfilling the statutory objective of "assisting small businesses." After the report was issued, Congress passed Public Law 104-19 to remove the small business requirement.

The audit covered the project startup period from May 1994 through December 1995. Excessive salaries included \$250,000 for the project director, which was about twice the director's salary at another Federally-funded genome center. Other inappropriate costs included charging SBA \$64,000 in bid and proposal costs related to a different Federal grant, counting \$17,000 in security deposits as expense, and incurring \$4,000 in unallowable travel and entertainment costs. In addition to recovering costs questioned, the Auditing Division also recommended that SBA negotiate lower salaries for the remainder of the project, with a potential savings of \$417,000

**Review of Federal Acquisition Streamlining Act of 1994 and Proposed Regulations**  
**Review of Federal Acquisition Streamlining Act of 1994 and Proposed Regulations**

The OIG reviewed proposed General Services Administration (GSA) Federal Acquisition Regulations (FAR) implementing Sections 6005 and 6006 of the Federal Acquisition Streamlining Act of 1994 (Act), which provide whistleblower protections for employees of Government contractors. We had

several significant concerns regarding the interpretation and impact of the Act. First, Sections 6005(b) and 6006(b) of the Act require an Inspector General (IG) to investigate all non-frivolous complaints of reprisal against contractor employees. The Act, however, does not specifically provide for IG access to a contractor's books, records, or employees for the purpose of obtaining evidence in such investigations. While individual agency regulations may provide for such access, it would be more effective to include language in the Act mandating contractor cooperation in such investigations.

Second, Sections 6005(b) and 6006(b) of the Act require the IG to submit a report of the findings of the investigation to the complainant, the contractor, and the head of the agency concerned. While the OIG does not oppose a requirement to provide some information to the complainant and the contractor concerning the results of the investigation, we question the need to provide a "report of the findings of investigation," particularly where the allegation is deemed unfounded. This requirement could have a chilling effect on the willingness of contractor employees to cooperate with OIG investigations, as individuals may be reluctant to face potential reprisal from their employers. Also, certain categories of information such as confidential informant, personal privacy, law enforcement process, and trade secret information are very sensitive and otherwise protected from disclosure by the Freedom of Information Act, the Privacy Act, and the Trade Secrets Act. At a minimum, we believe that an IG should consider and give weight to these

statutory provisions when releasing any information to a complainant or contractor under Sections 6005 and 6006 of the Act.

Third, Sections 6005(c) and 6006(c) of the Act provide that an agency head may take any of several actions if an IG investigation discloses improper reprisal against a whistleblower. Subsection (C) allows an agency head to order the contractor to pay the complainant's costs and expenses, including attorney fees and expert witness fees, incurred in bringing the complaint. We recommended that the Act be amended to allow an agency head to order the contractor to also pay the reasonable cost of any OIG investigation which substantiates a whistleblower's allegation of reprisal. This measure would provide some budget relief to the OIGs in an era of declining resources and increasing workload. The SBA/OIG faces a potentially substantial increase in its investigative workload with the passage of the Act, i.e., unless a complaint is deemed "frivolous," it must be investigated. Because of the nature and structure of the Section 8(a) minority set-aside program, SBA is the contracting agency and would have jurisdiction over all allegations filed by employees of Section 8(a) companies. No concomitant increase in investigative resources, however, has been provided by the Congress to address this workload.

Finally, Part 3.904 of the proposed implementing regulations provides that once an IG has completed an investigation of an alleged instance of reprisal and issued a report, "the head of the agency shall determine whether the report is

**complete** (emphasis added)." The regulations further provide that "if additional investigation is necessary the head of the agency may **direct** the Inspector General to continue the investigation (emphasis added)." While the Act confers the final decision authority on the agency head to determine whether reprisal has occurred and the type of penalty to be imposed, the use of the language quoted above serves to undermine the perception of the IG's impartiality, professionalism, and independence and serves no useful purpose. We therefore recommended that it be deleted.

### **Review of Paperwork Reduction Act Regulations**

The OIG reviewed OMB's proposed rule on "Controlling Paperwork Burdens on the Public; Regulatory Changes Reflecting Recodification of the Paperwork Reduction Act," 5 C.F.R. Part 1320. We opposed some provisions of the proposed regulation because of their potential to seriously erode the independence of the inspector general community throughout the Government.

Pursuant to Section 3(a) of the Inspector General Act of 1978, as amended, each IG reports to and is under the general supervision of the agency head, but the agency head does not have the authority to prevent or prohibit the IG from initiating, carrying out, or completing any audit or investigation. Under the Paperwork Reduction Act of 1995 and Section 1320.4(b) of the proposed OMB rules, however, the agency head or a designated senior official would have the

authority to impede certain types of IG audits and inspections of agency programs and operations; namely, audits or inspections that focus on a category of individuals or entities (such as a class of licensees or an entire industry) and that involve a survey or collection of information from ten or more persons. In such cases, the agency head or designated senior official must review the proposed survey to evaluate whether it should be approved by OMB and provide the public with 60 days to review and comment on the survey. The agency head or designated senior official must then certify that the information collection meets certain standards and forward the survey to OMB for final clearance.

We recommended that the most effective way to ensure the independence of the IGs is to exempt information collections related to audits and inspections of agency programs and operations from agency and OMB oversight, as well as the public comment period, in the same manner that audits and investigations which involve "an agency against specific individuals or entities" are currently exempted under Section 1320.4(a)(2) of the proposed regulations. The objectives of the Paperwork Reduction Act of 1995 can still be met by requiring each IG to conduct a review of all surveys and questionnaires exempted from agency and OMB review using criteria similar to those set forth in proposed Section 1320.8. Such procedures would ensure that an IG could fulfill his or her statutory obligation of conducting fair and complete audits and inspections of the agency's programs and supporting operations without interference from the agency head or

OMB.

We also voiced our concern that the approval process, as envisioned by the proposed rules, may cause delays as a result of disagreements regarding the information sought, the manner in which it is sought, or the necessity of any burden on the respondents which may be imposed by the collection activity. The approval process itself is lengthy, involving substantial time periods for public comment and for an OMB review alone that can take up to 90 days. Such delays in the identification and subsequent correction of fraud, abuse, inefficiency, ineffectiveness, or other deficiencies in an agency program places another burden on the public in the form of wasted resources which could be put to better use in providing services to the taxpayer.

If it is determined that IG collection activities cannot be exempted from the extensive approval process outlined in the proposed rules, then, at a minimum, we recommended a change to Section 1320.7(b) to allow an agency head to delegate, to the IG, full review authority for OIG collections of information.

**Review of Simplified  
Acquisition/FACNET  
Regulations**  
**Review of Simplified  
Acquisition/FACNET Regulations**

The OIG reviewed FAR Case 94-770, which would amend 48 C.F.R. Parts 2-53 to implement the new simplified acquisition and Federal Acquisition Computer Network (FACNET) requirements of the Federal Acquisition Streamlining Act of 1994. We had several significant concerns with the proposal. First, it would establish an electronic procurement process that allows agencies to transmit solicitations, provide notice of contract awards and orders, issue contracts and orders, and initiate payments to contractors. The private sector would be permitted to respond to solicitations, receive contracts and awards, and receive payment by automated means. We are concerned that this electronic procurement process may not provide the necessary safeguards or "evidence trails" necessary to detect and prosecute fraud against the Government. Under the traditional procurement process, Government contracts have generally included documents with signatures and dates to signify each side's acknowledgement of the penalties for fraud and failure to perform, as well as any other terms and conditions of the agreement. With an electronic system, however, some additional steps will be necessary to ensure that the necessary signatures and other legally binding acknowledgements of contract requirements and penalties are obtained. Without these documents, it will be extremely difficult, if not impossible, to successfully prosecute instances of contract fraud through either the criminal or civil process.

Second, the proposal states that contractors shall not enter into any

subcontract in excess of the simplified acquisition threshold (\$100,000) with a contractor that has been debarred, suspended, or proposed for debarment, unless there is a compelling reason to do so. We recommended that this prohibition apply to all subcontracts, regardless of dollar amount. A contractor that has been debarred or suspended for poor performance or unethical conduct (or any other grounds) should not have an opportunity to perform additional Government contracts, regardless of their dollar amounts.

Finally, the proposal would limit the need for appropriate certifications and contract clauses protecting the Government's interest to those contracts over the simplified acquisition threshold (\$100,000). Again, we recommended that these provisions apply to all contracts.

### **Activities to Enhance Fraud Detection and Deterrence**

#### **SBA/OIG Investigators Receive Deputation as Special Deputy U.S. Marshals**

A Memorandum of Understanding (MOU) has been signed by the SBA/OIG, the FBI, and DOJ implementing our part of a 1-year pilot project involving seven OIGs. Under the MOU, eligible SBA/OIG criminal investigators have been given a blanket deputation as Special Deputy U.S. Marshals. This MOU replaces the investigation-by-investigation request for special deputation that the OIG has been required to submit to DOJ prior to this pilot program. The MOU also gives OIG investigators, who have

met specified training requirements, full law enforcement powers, including authority to execute warrants, make arrests, and carry firearms in the performance of their official duties. During the past 6 months, OIG investigators have made eight arrests.

### **Fraud Awareness Briefings**

In addition to investigating complaints of waste, fraud, and abuse involving SBA programs, our investigations staff presented six Standards of Conduct briefings to a total of 160 Agency employees. The involvement and cooperation of all SBA employees in combatting waste, fraud, and abuse is critical to an effective OIG investigations program and to the Agency's overall productivity and efficiency.

During the reporting period, employee contributions to our mission were significant. As Figure 6 shows, almost 52 percent of all investigative referrals originated from within the Agency, in the form of referrals from either program heads or other SBA employees. This cooperation indicates the strong commitment of SBA employees to reducing waste, fraud, and abuse in Agency programs and improving the Agency's management and control of its programs.

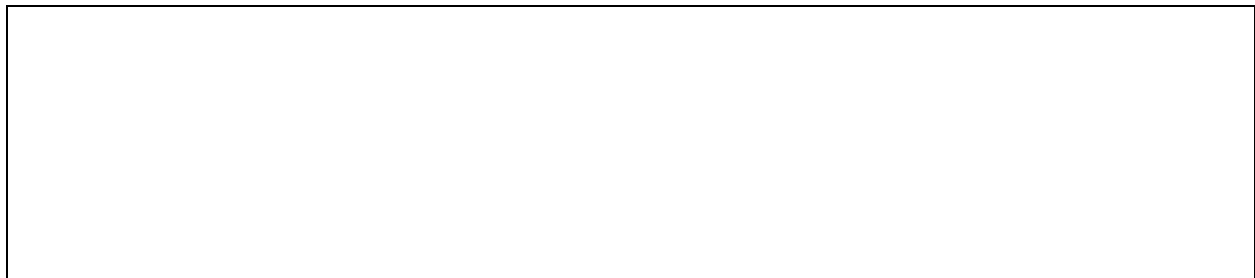
### **Pennsylvania Tax Return Preparer Pleads Guilty in Municipal Bond Fraud**

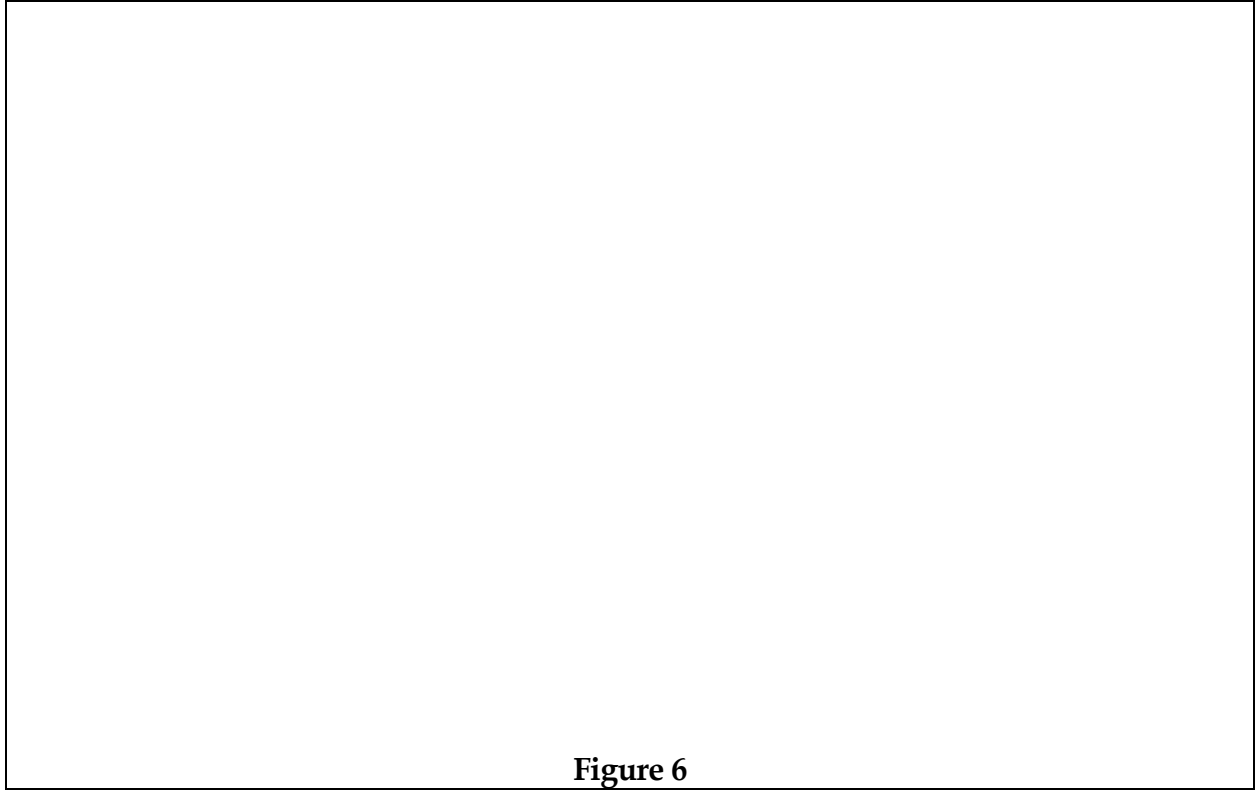
A Riegelsville, Pennsylvania, tax return preparer pled guilty to the one count of **mail fraud** with which he previously had been charged. The criminal information had been filed in connection with his scheme to defraud investors by selling them approximately \$1,143,000 of bogus tax-free municipal bonds purportedly guaranteed by SBA. The OIG's joint investigation with the Postal Inspection Service documented that the man designed the bonds, devised a fictitious name (the Upper Bucks County Industrial Development Authority), and falsely stated on the bonds that they were guaranteed by SBA. He then convinced clients and prospective clients of his business to purchase the bonds as a safe investment and a means of reducing their income tax liability. The bonds were sold between 1985 and 1993 to approximately 50 investors. The investigation was predicated on information supplied by SBA's Philadelphia District Office.

## **New York Teen Pleads Guilty to Forgery**

A 16-year-old from Clifton Park, New York, pled guilty to a two-count Juvenile Division information charging him with violating the **forgery** section of the New York State criminal code. The charges were the result of a joint investigation conducted by Western Union's security division, the U.S. Secret Service, and the SBA/OIG. The OIG entered the investigation when advised by Western Union Security that SBA telephone numbers assigned to the Disaster Assistance Area 4 Office in Sacramento, California, had been used to fraudulently wire-transfer funds via Western Union to various destinations in New York. The OIG's portion of the investigation involved analyzing SBA telephone system usage to determine whether any SBA employees participated in the scheme. The OIG was able to rule out any employee complicity and provide additional information to authorities which assisted in isolating the telephone number used to initiate the calls. This information aided in the identification of the young man as the computer "hacker" who had broken into the SBA telephone system to order the wire transfers. Simultaneously, a Secret Service informant identified the teenager as the

perpetrator of the scheme, and when he was arrested, law enforcement authorities seized computer equipment and modems from his room. He subsequently confessed and claimed that he had obtained instructions on how to perpetrate the scheme, as well as the telephone number to use, from the Internet. He claimed that he did not know who had put the information on the Internet.





**Figure 6**

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## Organization, Resources, and Management Initiatives

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The two missions of the Office of Inspector General are to help improve management in the Agency and to detect and deter fraud in SBA's programs. These two missions are accomplished through the provision of audit, investigation, and inspection and evaluation oversight to the Agency's portfolio and programs. This chapter provides an overview of the OIG's organizational structure and personnel and budget resources, and summarizes key internal management initiatives to use those resources as effectively as possible.

### Organization

The OIG is organized into four operating divisions as follows:

- Auditing Division
- Investigations Division
- Inspection and Evaluation Division
- Management and Legal Counsel Division

The Auditing and Investigations Divisions each administer their field activities through field offices and resident offices around the country. The Auditing Division has offices located in Atlanta, Dallas, Los Angeles, and Washington. In addition to these cities, the Investigations Division has offices in Denver, Kansas City, Seattle, Chicago, New York City, Philadelphia, San

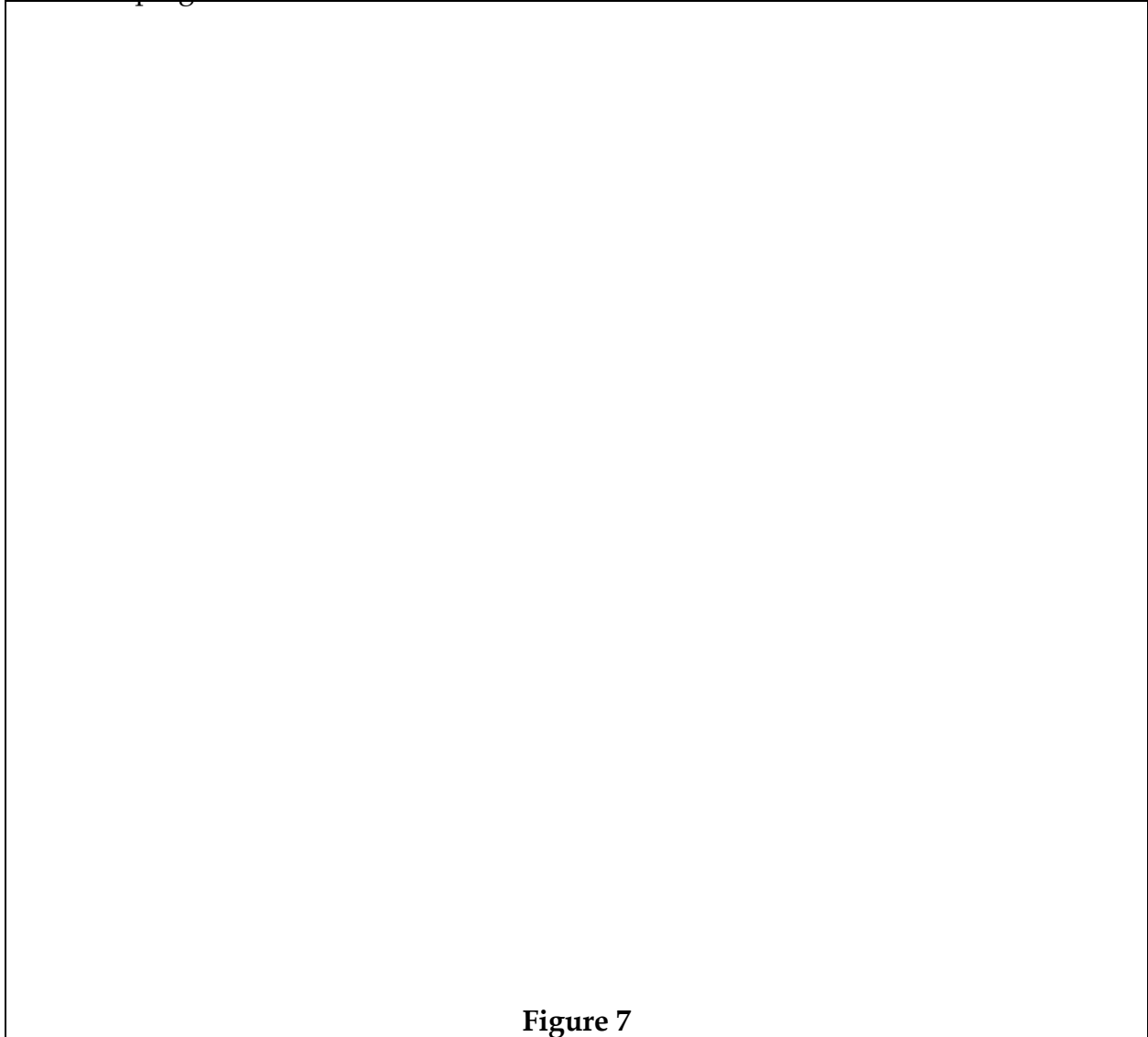
Francisco, and Syracuse.

Both the Inspection and Evaluation Division and the Management and Legal Counsel Division operate out of Washington, D.C. A current OIG organization chart can be found at Figure 7.

### Resources

In FY 1995, the OIG had an appropriation of \$8.5 million and an authorized personnel ceiling of 104 full-time equivalent (FTE) positions. While this appropriation represented an increase in dollars from the FY 1994 level of \$7.96 million, it also required a reduction in personnel resources from the FY 1994 level of 106 FTE positions. This reduction was executed in response to the President's FTE guidance. At the end of the current reporting period, the OIG had 102 employees on board.

In FY 1994, the OIG also received \$3 million in supplemental disaster funds to be used for activities related to the Agency's vastly expanded disaster assistance program.



These funds are available until expended. By the end of the current reporting period, six auditors, six investigators, and one staff support person had been hired on

temporary appointments, using disaster funding.

Within its regular appropriation of \$8.5 million, the OIG absorbed a portion of

the additional net cost of the Law Enforcement Availability Pay Act (mandated by the Congress last year). This law provides all criminal investigators with a 25 percent increase in their base salary as availability pay. The OIG budget also absorbed the combined cost-of-living and locality pay raises of an estimated 3.6 percent.

The continuing reduction in OIG FTE resources (104 FTE in FY 1995, and 102 FTE in FY 1996) is troubling. The expanding nature of the Agency's portfolio (almost \$33 billion at the end of FY 1995, as illustrated in Figures 1 and 2, compared to \$26.6 billion at the end of FY 1994) and its concomitant demand for OIG oversight would suggest that resources be increased to ensure adequate oversight.

At this writing, the Federal Government is conducting its FY 1996 operations under the provisions of a Continuing Resolution. Pending the passage and signing of a FY 1996 budget, spending levels are pegged to a formula 5 percent below the average of the Senate and House of Representatives budget marks. Given that both the House and Senate marks are significantly below the level of the President's current services budget request for the OIG, there exists a heightened sense of concern in this office. Legislatively-mandated implementation of availability pay (25 percent of base salary for all OIG criminal investigators) is largely unfunded. The proposed annual cost-of-living and locality pay increases are not funded at all. While alternative strategies for operating under a severely

reduced budget are being formulated, none of the options bode well for the OIG's ability to carry out its mandate to provide oversight to the Agency's programs and activities and to safeguard the Government's investment in the extensive programs of the Agency.

The OIG continues to be concerned with the increasing demand for investigations of fraud in Agency programs. As evidenced by the table on page 79, business loan fraud continues to be our major area of concentration, in terms of both number of active cases carried and time expended on those cases. Disaster loan fraud qualifies as the second largest area for investigative activity, in terms of both number of cases and time expended. This reporting period was the first time in at least 5 years that business and disaster loan fraud consumed more than 75 percent of the OIG's investigative time, and, during the fourth quarter, their combined share exceeded 80 percent. With 1995 having been the busiest hurricane season in more than a generation, and with demand for SBA business loans remaining high, we expect that our investigative efforts will continue to be preoccupied by those two programs and our resources stretched severely. The table on page 79 also illustrates the Auditing Division's emphasis on the business loan and disaster assistance programs. It is of note that the Auditing Division's effort in the disaster assistance program has gone from 3 percent to 10 percent to 25 percent, respectively, during the last 3 reporting periods.

## **Efforts to Improve SBA Program Management**

Inspector General Alerts Congress Concerning Dangers Associated With Deep SBA Budget Cuts. In letters sent to members of selected Congressional oversight and budget committees, the IG, in line with his responsibility to keep the Congress of the United States ". . . fully and currently informed about the problems and deficiencies relating to the administration of . . . programs and operations and the necessity for and progress of correction action," raised the issue of serious consequences which will result from the possible severe budget cuts planned by Congress. His letter stated in part:

As I understand the situation, the Senate Appropriations Committee has marked the Agency's 7(a) program at \$133 million and assumes a reduced subsidy rate of 1.07%, the net effect being that the 7(a) loan program will rise from an estimated \$7.8 billion in FY 1995 to \$12.4 billion in FY 1996. In addition, the Small Business Development Center program will also increase by \$3 million. While the intent of getting more money and technical assistance to the small business community is laudable, I am troubled that both the Agency and the OIG's capability for managing and overseeing the successful delivery of these significant program increases would be diminished markedly. . . .

## **Efforts to Improve Internal Management**

Annual Training Seminar and Professional Development Held  
Annual Training Seminar and Professional Development Held for Professional and Support Staffs. Two training sessions, one for professional staff and one for support staff, were held during the reporting period. The SBA's Deputy Administrator addressed the professional staff session in Baltimore, Maryland, and the Agency's Administrator provided a videotape address which he recorded specifically for the occasion. Support staff held their training session in Washington, D.C.

Training topics for investigators included presentations on bloodborne pathogens, arrest techniques and nonlethal control, mental preparedness for armed confrontation, and firearms on airplanes. Auditors and inspectors received training in loan administration, loan liquidation, and loan processing. Management and legal counsel staff attended a session on project management. In addition, all OIG staff received instruction on the use of IG subpoenas. Support staff received computer software application training, which prepared them for anticipated Agency electronic data processing upgrades.

Additional Education and Training Events Presented to OIG Staff. A full day of training for OIG senior managers was presented on the topic of implementing the Government Performance and Results Act. The training focussed on developing an OIG strategic plan and supporting objectives, performance targets, and appropriate outcome measures.

All headquarters OIG staff attended a

full-day's training seminar on writing skills. The training was conducted pursuant to an OIG-wide initiative to improve the quality and readability of OIG reports and other products.

### **President's Council on Integrity and Efficiency**

The Inspector General is a member of the President's Council on Integrity and Efficiency (PCIE) and serves as chairman of the PCIE's Committee on Inspection and Evaluation. He participates in PCIE initiatives to reduce fraud and improve the management of Federal programs on a Government-wide basis. During the reporting period, the IG and his staff have contributed to several key PCIE initiatives:

- The IG continues to serve on the task force developing performance measures for the inspector general community.
- The IG, in his role as Chairman of the Committee on Inspection and Evaluation, commissioned and presented a definitive review of inspection and evaluation activities across the inspector general community.
- Substantive comments were submitted to the Chair of the PCIE on a draft Executive Order covering administrative allegations against Inspectors General. Comments were also provided on a draft allegation referral process to implement the order.

### **Survey of Inspection and Evaluation Units in the Inspector General Community**

At the request of the SBA Inspector General, chair of the Inspection and Evaluation Committee of the PCIE, an interagency group representing 20 OIG offices surveyed the wide range of services performed by inspection and evaluation units across the inspector general community. The study noted that a key asset of these units is their flexibility and diversity, i.e., each is tailored to meet the individual needs of the OIG and host agency in which it is located. While the roles of inspection and evaluation units may vary considerably, most focus on policy and program performance and fill important gaps in traditional OIG coverage.

### **Review of Inspector General Law Enforcement Act of 1995**

We reviewed and strongly supported a President's Council on Integrity and Efficiency legislative proposal to grant full law enforcement authority to Inspectors General. The proposal, if enacted, would authorize OIG criminal investigators to execute and serve warrants and subpoenas, make arrests, and carry firearms. We strongly support this proposal as a necessary adjunct to our investigative responsibilities and an efficient alternative to the current system of seeking deputation in individual cases.

### **Contracting Out of Background Investigations Creates Savings**

The OIG Investigations Division is responsible for ensuring that all SBA employees have the appropriate security clearance and level of background investigation to meet the requirements of their positions. In the past, all employee background investigations were contracted out to the Office of Personnel Management (OPM). In FY 1995, as a Government reinvention initiative, the OIG obtained approval from OPM to begin contracting with private companies to conduct these investigations as a cost saving initiative. Fifty-eight background investigations were conducted in FY 1995 for a total cost of \$62,140. Had OPM conducted these investigations, the total cost would have been \$129,070. The OIG consequently saved almost \$67,000 by obtaining permission from OPM to contract out.

### **OIG Upgrades Computer Hardware to Meet Agency Standards OIG Upgrades Computer Hardware to Meet Agency Standards**

The OIG completed a general upgrade of its computer equipment by replacing and upgrading obsolete computers and providing laptop computers to selected field personnel. The new computers will be able to handle standard Agency software, including Windows 95, electronic mail and software which supports SBA's LANs, as well as communications between field offices using the Agency's Wide Area Network (WAN). These capabilities will improve the efficiency of each OIG staff member and will enhance the OIG's ability to prepare high quality, professional-looking documents.



**Direct Investigation Time by Program Area**  
**Direct Investigation Time by Program Area**  
**Area**  
**April 1, 1995 to September 30, 1995**

| Program Area                    | Direct Time % | Number of Investigations |             |
|---------------------------------|---------------|--------------------------|-------------|
|                                 |               | Closed                   | In Progress |
| Business Loans                  | 56            | 27                       | 203         |
| Disaster Loans                  | 28            | 16                       | 61          |
| SBIC                            | 7             | 3                        | 16          |
| Surety Bonds                    | 0             | 0                        | 1           |
| Government Contracting          | 1             | 0                        | 7           |
| Minority Enterprise Development | 4             | 11                       | 21          |
| Economic Development            | 0             | 0                        | 1           |
| Agency Mgt. and Financial       | 4             | 17                       | 20          |
| <b>Total</b>                    | <b>100</b>    | <b>74</b>                | <b>330</b>  |

**Direct Auditing Time by Program Area**  
**Direct Auditing Time by Program Area**  
**Area**  
**April 1, 1995 to September 30, 1995**

| Program Area                    | Direct Time % | Number of Audits |             |
|---------------------------------|---------------|------------------|-------------|
|                                 |               | Issued           | In Progress |
| Business Loans                  | 35            | 3                | 5           |
| Disaster Loans                  | 25            | 0                | 5           |
| SBIC                            | *             | 0                | 0           |
| Surety Bonds                    | 0             | 0                | 0           |
| Government Contracting          | 0             | 0                | 0           |
| Minority Enterprise Development | 23            | 2                | 6           |
| Economic Development            | 9             | 2                | 1           |
| Agency Mgt. and Financial       | 8             | 5                | 1           |
| <b>Total</b>                    | <b>100</b>    | <b>12</b>        | <b>18</b>   |

\* less than 1 percent

# Profile of Operating Results

April 1, 1995 to September 30, 1995

## Audit Activities ..... Totals

|   |              |
|---|--------------|
| A. Reports Issued .....   | 12           |
| B. Desk Reviews of CPA Audit Reports Issued .....                       | 0            |
| C. Audit Recommendations Issued .....                                   | 65           |
| D. Dollar Value of Costs Questioned .....                               | \$566,772    |
| E. Dollar Value of Recommendations that Funds Be Put to Better Use *... | \$10,359,205 |

## Audit Followup Activities

|   |              |
|---|--------------|
| F. Audit Recommendations Closed .....   | 24           |
| G. Disallowed Costs Agreed to by Management .....   | \$167,790    |
| H. Dollar Value of Recommendations that Funds Be Put to Better Use<br>Agreed to by Management ..... | \$3,980,783  |
| I. Unresolved Audit Recommendations .....   | 81           |
| J. Dollar Value of Unresolved Audit Recommendations .....   | \$28,233,656 |

## Inspection Activities

|                         |   |
|-------------------------|---|
| A. Reports Issued ..... | 2 |
|-------------------------|---|

## Legislation/Regulation/SOP/Other Reviews

|   |    |
|---|----|
| A. Legislation Reviewed .....                   | 4  |
| B. Regulations Reviewed .....                   | 31 |
| C. Standard Operating Procedures Reviewed ..... | 9  |
| D. Other Issuances ** .....                     | 76 |

\* Includes amounts for more effective use of program participant funds in the furtherance of Government programs.

\*\* This is a new category being reported in FY 1995; it includes policy notices, procedural notices, Administrator's action memoranda, and other communications which frequently involve the implementation of new programs and policies. During this reporting period, we continued to review a significant number of such issuances submitted to us for clearance.

**Status of Investigations as of September 30, 1995** **Totals**

|                       |     |
|-----------------------|-----|
| A. Total Cases .....  | 404 |
| B. Closed Cases.....  | 74  |
| C. Pending Cases..... | 37  |
| D. Open Cases .....   | 293 |

**Summary of Indictments and Convictions**

|                                    |    |
|------------------------------------|----|
| A. Indictments from OIG Cases..... | 31 |
| B. Convictions from OIG Cases..... | 27 |

**Summary of Recoveries and Reductions of Risk**

|  |                         |
|--|-------------------------|
| A. Potential Recoveries and Fines as a Result of OIG Investigations..... | \$4,385,377             |
| B. Reductions of Financial Risk as a Result of OIG Investigations.....   | \$142,400               |
| C. Reductions of Financial Risk as a Result of the Name Check Program..  | <u>\$18,715,116</u>     |
| <br>Total:.....  | <br><u>\$23,242,893</u> |

**SBA Personnel Actions Taken as a Result of Investigations**

|                                  |   |
|----------------------------------|---|
| A. Dismissals .....              | 1 |
| B. Resignations/Retirements..... | 1 |
| C. Suspensions.....              | 2 |
| D. Reprimands.....               | 3 |

**Program Actions Taken as a Result of Investigations**

|                               |   |
|-------------------------------|---|
| A. Suspensions.....           | 0 |
| B. Debarments .....           | 0 |
| C. Removals from Program..... | 0 |
| D. Other Program Actions..... | 0 |

**Summary of OIG Fraud Line Operation**

|   |       |
|---|-------|
| A. Total Fraud Line Calls/Letters .....   | 1,360 |
| B. Total Calls/Letters Referred to Offices Outside the OIG.....                 | 1,331 |
| C. Total Calls/Letters Referred to Investigations Division for Evaluation ..... | 29    |

**Investigations Activities - Referral Program**

|  |          |
|--|----------|
| A. Cases Referred to FBI.....  | 39       |
| B. Referred to Other Agencies (Excluding FBI).....                     | 7        |
| C. Indictments from Referrals.....                                     | 5        |
| D. Convictions from Referrals.....                                     | 6        |
| E. Potential Recoveries and Fines as a Result of Referral Program..... | \$78,362 |
| F. Reductions of Financial Risk as a Result of Referral Program.....   | \$0      |

**Office of Inspector General**  
**Staffing as of September 30, 1995**

|  |                |
|--|----------------|
| A. Immediate Office.....                       | 3              |
| B. Auditing Division.....                      | 34             |
| Professional.....                              | 30             |
| Support.....                                   | 4              |
| C. Investigations Division .....               | 48             |
| Professional.....                              | 39             |
| Support.....                                   | 9              |
| D. Inspection and Evaluation Division .....    | 8              |
| Professional.....                              | 7              |
| Support.....                                   | 1              |
| E. Management and Legal Counsel Division ..... | 9              |
| Professional.....                              | 7              |
| Support.....                                   | 2              |
| <br>OIG Total.....                             | <br><u>102</u> |

**Additional Temporary Disaster Staffing**  
**Funded From Supplemental Appropriations**

|                                 |        |
|---------------------------------|--------|
| A. Auditing Division .....      | 6      |
| B. Investigations Division..... | 7      |
| <br>OIG Disaster Total.....     | <br>13 |

# FY 1995 Productivity Statistics

## Second Six Months

| <b>Office-Wide Dollar Accomplishments</b>  | <b>Totals</b>              |
|--|----------------------------|
| A. Potential Investigative Recoveries and Fines.....                                 | \$4,385,377                |
| B. Management Avoidances as Result of Investigations .....                           | \$18,857,516               |
| C. Disallowed Costs Agreed to by Management .....                                    | \$167,790                  |
| D. Recommendations that Funds Be Put to Better<br>Use Agreed to by Management *..... | \$3,980,783                |
| <b>Total</b> .....   | <b><u>\$27,391,466</u></b> |

### Auditing Division Activities

|   |             |
|---|-------------|
| A. Reports Issued.....  | 12          |
| B. Disallowed Costs Agreed to by Management.....                                    | \$167,790   |
| C. Recommendation that Funds Be Put to Better<br>Use Agreed to by Management *..... | \$3,980,783 |

### Inspection and Evaluation Division Activities

|                        |   |
|------------------------|---|
| A. Reports Issued..... | 2 |
|------------------------|---|

### Investigations Division Activities

|  |              |
|--|--------------|
| A. Cases Closed.....                                 | 74           |
| B. Indictments .....                                 | 31           |
| C. Convictions .....                                 | 27           |
| D. Potential Investigative Recoveries and Fines..... | \$4,385,377  |
| E. Management Avoidances .....                       | \$18,857,516 |
| - Investigation Cases.....                           | \$142,400    |
| - Name Check Program.....                            | \$18,715,116 |

\* Includes amounts for more effective use of program participant funds in the furtherance of Government programs.

# FY 1995 Productivity Statistics

## Full Year

| Office-Wide Dollar Accomplishments   | Totals                     |
|--|----------------------------|
| A. Potential Investigative Recoveries and Fines.....                                 | \$8,319,572                |
| B. Management Avoidances as Result of Investigations .....                           | \$32,948,876               |
| C. Disallowed Costs Agreed to by Management .....                                    | \$179,540                  |
| D. Recommendations that Funds Be Put to Better<br>Use Agreed to by Management *..... | \$5,608,242                |
| <b>Total .....</b>   | <b><u>\$47,056,230</u></b> |

### Auditing Division Activities

|   |             |
|---|-------------|
| A. Reports Issued.....  | 20          |
| B. Disallowed Costs Agreed to by Management.....                                    | \$179,540   |
| C. Recommendation that Funds Be Put to Better<br>Use Agreed to by Management *..... | \$5,608,242 |

### Inspection and Evaluation Division Activities

|                        |   |
|------------------------|---|
| A. Reports Issued..... | 3 |
|------------------------|---|

### Investigations Division Activities

|  |              |
|--|--------------|
| A. Cases Closed.....                                 | 131          |
| B. Indictments .....                                 | 77           |
| C. Convictions .....                                 | 78           |
| D. Potential Investigative Recoveries and Fines..... | \$8,319,572  |
| E. Management Avoidances .....                       | \$32,948,876 |
| - Investigation Cases.....                           | \$4,525,530  |
| - Name Check Program .....                           | \$28,423,346 |

\* Includes amounts for more effective use of program participant funds in the furtherance of Government programs.

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## **Statutory Reporting Requirements**

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The specific reporting requirements as prescribed in the Inspector General Act of 1978, as amended by the Inspector General Act Amendments of 1988, are listed below.

| <b>Source</b>  | <b>Location in this Report</b> |
|--|--------------------------------|
| Section 4(a)(2) - Review of Legislation and Regulations  | Pages 6 - 71                   |
| Section 5(a)(1) - Significant Problems, Abuses, and Deficiencies                                 | Pages 6 - 71                   |
| Section 5(a)(2) - Recommendations With Respect to Significant Problems, Abuses, and Deficiencies | Pages 6 - 71                   |
| Section 5(a)(3) - Prior Significant Recommendations Not Yet Implemented                          | Page 94                        |
| Section 5(a)(4) - Matters Referred to Prosecutive Authorities                                    | Pages 6 - 71                   |
| Section 5(a)(5) and 6(b)(2) - Summary of Instances Where Information Was Refused                 | None                           |
| Section 5(a)(6) - Listing of Audit Reports   | Page 88                        |
| Section 5(a)(7) - Summary of Significant Audits  | Pages 6 - 71                   |
| Section 5(a)(8) - Audit Reports Containing Questioned Costs                                      | Page 90                        |
| Section 5(a)(9) - Audit Reports Recommending that Funds Be Put to Better Use                     | Page 91                        |
| Section 5(a)(10) - Summary of Reports Where No Management Decision Was Made                      | Page 93                        |
| Section 5(a)(11) - Significant Revised Management Decisions                                      | None                           |
| Section 5(a)(12) - Significant Management Decisions With Which OIG Disagreed                     | None                           |

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## APPENDIX I APPENDIX I

### Audit Reports Issued April 1, 1995 to September 30, 1995

| TITLE                                      | NUMBER     | ISSUE DATE | QUESTIONED COSTS | FUNDS FOR BETTER USE |
|--|------------|------------|------------------|----------------------|
| <b>Business Loans</b>                      |            |            |                  |                      |
| Section 7(a) Credit Elsewhere              | 53W010018  | 9/18/95    |                  | \$6,000,000          |
| Cordoba Corporation - Guaranteed Loan      | 55H004015  | 8/10/95    |                  | \$580,000            |
| Administration of \$825,000 Line of Credit | 55H004016  | 8/18/95    |                  |                      |
| PROGRAM SUBTOTAL:                          | Reports: 3 |            | \$0              | \$6,580,000          |
| <b>Minority Enterprise Development</b>     |            |            |                  |                      |
| 8(a) Competitive Mix                       | 53E010021  | 9/29/95    |                  |                      |
| Diversified International Sciences Corp.   | 55H005020  | 9/29/95    |                  |                      |
| PROGRAM SUBTOTAL:                          | Reports: 2 |            | \$0              | \$0                  |
| <b>Economic Development</b>                |            |            |                  |                      |
| University of Puerto Rico SBDC             | 54H005013  | 6/30/95    | \$99,757         |                      |
| Puerto Rico District Monitoring of SBDC    | 55H012017  | 8/31/95    |                  |                      |
| PROGRAM SUBTOTAL:                          | Reports: 2 |            | \$99,757         | \$0                  |

| <b>Agency Management and Financial</b>          |             |         |           |              |
|---|-------------|---------|-----------|--------------|
| FY 1994 Financial Statements - Mgt. Letter      | 54H009012   | 6/28/95 |           |              |
| FY 1994 Financial Statements                    | 54H009010   | 6/1/95  |           |              |
| National Education Center for Women in Business | 54H003014   | 8/4/95  | \$319,742 |              |
| National Center for Genome Resources (Interim)  | 55H008011   | 6/7/95  |           | \$3,348,388  |
| National Center for Genome Resources            | 55H008019   | 9/29/95 | \$147,273 | \$430,817    |
| PROGRAM SUBTOTAL:                               | Reports: 5  |         | \$467,015 | \$3,779,205  |
|   |             |         |           |              |
| TOTALS:   | Reports: 12 |         | \$566,772 | \$10,359,205 |

## APPENDIX II - Part A

### Audit Reports with Questioned Costs April 1, 1995 to September 30, 1995

|    |  | REPORTS | RECs* | DOLLAR VALUES |             |
|----|--|---------|-------|---------------|-------------|
|    |  |         |       | QUESTIONED    | UNSUPPORTED |
| A. | For which no management decision had been made by April 1, 1995      | 4       | 8     | \$1,969,619   |             |
| B. | Which were issued during the period                                  | 3       | 10    | \$566,772     |             |
|    | Subtotals (A + B)  | 7       | 18    | \$2,536,391   |             |
| C. | For which a management decision was made during the reporting period | 2       | 2     | \$167,790     |             |
|    | (i) Disallowed costs   | 2       | 2     | \$167,790     |             |
|    | (a) Due SBA  | 2       | 2     | \$167,790     |             |
|    | (b) Due program participant  |         |       |               |             |
|    | (ii) Costs not disallowed  |         |       |               |             |
| D. | For which no management decision had been made by September 30, 1995 | 7       | 16    | \$2,368,601   |             |

\* Recommendations

## APPENDIX II - Part B

### Audit Reports with Recommendations that Funds Be Put to Better Use April 1, 1995 to September 30, 1995

|    |  | REPORTS | RECs* | RECOMMENDED<br>FUNDS FOR<br>BETTER USE |
|----|--|---------|-------|--|
| A. | For which no management decision had been made by April 1, 1995      | 3       | 7     | \$19,486,633                           |
| B. | Which were issued during the period                                  | 4       | 4     | \$10,359,205                           |
|    | Subtotals (A + B)  | 7       | 11    | \$29,845,838                           |
| C. | For which a management decision was made during the reporting period | 3       | 3     | \$3,980,783                            |
|    | (i) Recommendations agreed to by SBA management                      | 3       | 3     | \$3,980,783                            |
|    | (a) SBA level  | 3       | 3     | \$3,980,783                            |
|    | (b) Program participant level  |         |       |  |
|    | (ii) Recommendations not agreed to by SBA management                 |         |       |  |
| D. | For which no management decision had been made by September 30, 1995 | 5       | 8     | \$25,865,055                           |

\* Recommendations

## APPENDIX II - Part C APPENDIX II - Part C

### Audit Reports with Non-Monetary Recommendations April 1, 1995 to September 30, 1995

|    |  | REPORTS | RECOMMENDATIONS |
|----|--|---------|-----------------|
| A. | For which no management decision had been made by April 1, 1995      | 6       | 25              |
| B. | Which were issued during the period                                  | 9       | 51              |
|    | Subtotals (A + B)  | 15      | 76              |
| C. | For which a management decision was made during the reporting period | 3       | 19              |
| D. | For which no management decision had been made by September 30, 1995 | 13      | 57              |

## APPENDIX II - Part D APPENDIX II - Part D

### Overdue Management Decisions September 30, 1995

| AUDITEE                                  | REPORT NUMBER | ISSUED   | STATUS                            |
|--|---------------|----------|-----------------------------------|
| <b>Business Loans</b>                    |               |          |                                   |
| Standard Chartered Bank                  | 4-3-C-001-002 | 10/22/93 | Under legal review                |
| Tara State Bank                          | 4-3-E-005-001 | 10/22/93 | Under legal review                |
| Colson Services Corp.                    | 3-2-S-401-014 | 12/3/92  | In negotiation with auditee       |
| Loan Servicing and Debt Collection       | 5-3-H-004-006 | 3/31/95  | Delay requested by program office |
| Population and Marketing Analysis Center | 5-4-H-008-008 | 3/31/95  | Awaiting response from auditee    |
| Indiana Lumbersmens Mutual Insurance Co. | 5-4-W-001-009 | 3/31/95  | Under legal review                |

## APPENDIX II - Part E

### Significant Audit Reports Described in Prior Semiannual Reports Without Final Action as of September 30, 1995

| REPORT NUMBER | TITLE   | DATE ISSUED | DATE OF MANAGEMENT DECISION | FINAL ACTION TARGET |
|---------------|---|-------------|-----------------------------|---------------------|
| 0-1-0-007-140 | Regulations for 301(d)                            | 06/13/90    | 09/30/93                    | 12/31/93            |
| 2-2-W-400-065 | Integon Indemnity Corp.                           | 03/31/92    | 09/30/92                    | 03/31/95            |
| 2-2-S-401-078 | Residual Service Fee                              | 05/26/92    | 08/19/92                    | 09/30/93            |
| 3-2-S-401-014 | Colson Service Corp.                              | 12/03/92    | *                           | *                   |
| 3-3-T-001-024 | Energy Management                                 | 02/25/93    | 09/30/93                    | 11/30/93            |
| 3-3-E-002-025 | Controls over Advisory and Assistance Services    | 03/01/93    | 03/10/93                    | 03/31/93            |
| 3-2-C-002-033 | Administration of 8(a) Program                    | 03/31/93    | 09/30/94                    | 09/30/95            |
| 3-2-H-007-036 | SBA's Oversight of Colson Services Corp.          | 06/16/93    | 03/31/95                    | 09/30/95            |
| 3-3-H-001-043 | SBA FY 1992 Financial Statements                  | 07/16/93    | 03/31/94                    | 03/31/95            |
| 4-3-E-005-001 | Tara State Bank                                   | 10/22/93    | *                           | *                   |
| 4-3-C-001-002 | Standard Chartered Bank                           | 10/22/93    | *                           | *                   |
| 4-3-H-011-016 | SBA's Award of 8(a) Contracts to ASCI             | 05/16/94    | 12/30/94                    | 06/30/95            |
| 4-3-W-009-018 | Washington State SBDC                             | 08/01/94    | 03/31/95                    | 05/31/95            |
| 4-4-E-005-024 | Brokering of 8(a) Contracts                       | 09/30/94    | 03/21/95                    | None                |
| 4-3-H-012-020 | SBA FY 1993 Financial Statements                  | 08/31/94    | 10/18/95                    | 06/30/95            |
| 4-2-E-403-019 | Pulsar Data Systems                               | 08/15/94    | 03/22/95                    | None                |
| 5-3-H-004-006 | SBA Loan Servicing and Debt Collection Activities | 03/31/95    | *                           | *                   |
| 5-3-E-011-002 | Central Wisconsin Hardwood, Inc.                  | 11/25/94    | 12/30/94                    | None                |
| 5-4-W-001-009 | Indiana Lumbermens Mutual Insurance Co.           | 03/31/95    | *                           | *                   |

| <b>REPORT NUMBER</b> | <b>TITLE</b>                             | <b>DATE ISSUED</b> | <b>DATE OF MANAGEMENT DECISION</b> | <b>FINAL ACTION TARGET</b> |
|----------------------|--|--------------------|------------------------------------|----------------------------|
| 5-4-H-008-008        | Population and Marketing Analysis Center | 03/31/95           | *                                  | *                          |
| 5-5-H-007-003        | SBA FY 1994 Financial Statements         | 12/13/94           | *                                  | *                          |

\* A management decision has not been made on all recommendations in the audit report.



**SAR -- 4/1/95 to 9/30/95**  
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|  |    |
|--|----|
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|  |    |
|--|----|
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