UNITED STATES OF AMERICA
DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
Washington, D.C.

In the Matter of:	*	
KEVIN VESTER and RAY SHAWN VINSON III,	*	**DOCKET NO.: 17-0022-DB**
Respondents.	*	

DEBARRING OFFICIAL'S DETERMINATION

INTRODUCTION

By separate Notices of Proposed Debarment dated February 28, 2017 ("Notice" or "Notices"), the Department of Housing and Urban Development ("HUD") notified Respondents KEVIN VESTER and RAY SHAWN VINSON III that HUD was proposing their debarment from future participation in procurement and nonprocurement transactions as a participant or principal with HUD and throughout the Executive Branch of the Federal Government for a three-year period from the date of final determination of the proposed action. The Notice advised Respondents also that their proposed debarment was in accordance with the regulations at 2 C.F.R. parts 180 and 2424 and was based on their submission of a management response and audited financial statements that contained errors or false information, which provided cause for their debarment pursuant to 2 C.F.R. § 180.800(b) and (d).

A hearing on Respondents' proposed debarment was held in Washington, D.C. on October 10, 2017 before the Debarring Official's Designee, Mortimer F. Coward. Jeffrey K. Lucas appeared on behalf of Respondents. Ross A. Fisher, Esq., Barrett R. McVary, Esq., and Brian A. Dupre, Esq. appeared on behalf of HUD.

SUMMARY

I have decided, pursuant to 2 C.F.R. part 180, to debar Respondents from future participation in procurement and nonprocurement transactions, as a participant, principal, or

contractor with HUD and throughout the Executive Branch of the Federal Government, for a period of three years from the date of this Determination. My decision is based on the administrative record in this matter, which includes the following information:

(1) The separate Notices of Proposed Debarment dated February 28, 2017.

(2) The Government's Pre-Hearing Brief in Support of a Three-Year Debarment for Both Kevin Vester and Ray Vinson III filed May 22, 2017 (including all exhibits and attachments thereto).

(3) Respondents Kevin Vester and Ray Vinson, III Pre-Trial Statement filed July 31, 2017.

(4) The Government's Supplemental Brief in Further Support of Debarment filed August 15, 2017.

GOVERNMENT COUNSEL'S ARGUMENTS

Government counsel states that Respondents Vinson and Vester, co-owners and president and vice-president, respectively, of Vincent Mortgage Services, Inc., (the "company" or "VMS"), willfully misrepresented to HUD the financial condition of the company, a HUD-approved mortgagee. Specifically, in a Notice of Violation issued by HUD, the company was cited for failing to provide HUD with "acceptable" audited financial statements and other reports relating to fiscal year 2013. For Respondents, the provenance of the problem was the company's adjusted net worth, which, at the end of fiscal year 2013, was below the regulatory minimum. In an attempt to cure the deficiency, Respondents negotiated an SBA loan, which also involved their company. However, Respondents "willfully misrepresented" to HUD and in their financial statements for FY 2013 and FY 2014 that the loan was not a liability of the company.[1]

As a participant in HUD's Title II program, Respondents and their company were required to comply with relevant HUD regulations. More particularly, Respondents were required, with respect to the company's financial documents that must be filed annually with HUD, to ensure that their filings complied with Generally Accepted Accounting Principles (GAAP), HUD's Office of Inspector General Handbook 2000.04, 24 C.F.R. §§ 202.5 and 202.7, Generally Accepted Auditing

[1] Although only two fiscal years are mentioned here, at the heart of the dispute are three documents – the "original" FY 2013 audit, a second FY 2013 audit, and a 2014 audit. HUD alleges that the misrepresentations and false statements were made in the second FY 2013 audit and in the 2014 audit.

Standards (GAAS), the Generally Accepted Government Auditing Standards (GAGAS), and other regulatory enactments. Among other things, these authorities set forth the "acceptable" standards that participants in the FHA program seeking recertification must meet, the methodology for calculating a company's adjusted net worth, including the treatment of assets that are considered "unacceptable," that is, "any asset or portion thereof pledged to secure the obligations of another entity or any person." In this regard, counsel notes that Respondents were the responsible parties for preparing the company's FY 2014 audit and the Second FY 2013 audit, so it was their responsibility to ensure that the "financial statements were acceptable, were in accordance with GAAP, and that the financial statements were 'free from material misstatement, whether due to fraud or error.'"

During the FY 2013 audit of the company's financial statements required by HUD as part of the annual recertification process, the auditor made a finding of material noncompliance with HUD's adjusted net worth requirement. One of the next steps in the process requires the mortgagee to submit a Corrective Action Plan that spells out its proposed actions to address the findings noted by the auditor. Because there was a finding that the company had a net worth deficiency in FY 2013, the company was required to submit a Corrective Action Plan that would meet HUD's requirements to maintain the company's FHA approval. Respondents, in the Corrective Action Plan they submitted to HUD, wrote that they would obtain "SBA loans to provide funds for capital contribution from new shareholders." Respondent Vinson had been unsuccessful in his quest for personal loans that would be used to make a capital contribution to the company. Thereafter, the company applied for and received a loan of $932,000.00 from Fortune Bank that was guaranteed by the Small Business Administration (SBA).

The relevant loan documents indicate that all "individuals and entities signing this note are jointly and severally liable." Respondents and Vinson Mortgage Services, Inc. are listed as the borrowers on the loan. Additionally, the company pledged all its assets except real estate as collateral for the loan. Respondents signed the loan documents in both their individual and official capacities.[2] Counsel also notes that the company failed to inform HUD of "the exact . . . source of the cash infused" into the company as part of the Corrective Action Plan. Further, Respondents did

[2] In a separate but related action, Respondents argued that they had a separate understanding that they as individuals were responsible for repayment of the loan. The document supporting Respondents' claim, counsel notes, is dated February 28, 2017, the same date the Notices of Proposed Debarment were issued. The SBA documents contain a provision requiring that any change in the terms of the SBA loan must be in writing and signed by all affected parties.

not inform HUD of the company's potential liability in connection with the loan in the event of default because of a joint and several liability provision in the loan documents. To the contrary, the company's financial statements referred to the proceeds of the loan invested in the company as paid-in capital instead of as a liability. Respondent's description of the loan as a capital contribution was inconsistent with GAAP, was a material misstatement, and resulted in the submission of an erroneous balance sheet. In addition, the incorrect treatment of the loan proceeds resulted in an erroneous calculation of the adjusted net worth. More to the point, an accurate treatment of the SBA loan would increase the value of the unacceptable assets by $926,249.05, an amount equal to the balance of the SBA loan on December 31, 2014. As such, for FY 2013 and FY 2014, the company had an adjusted net worth deficiency and, thus, did not satisfy HUD guidelines. Respondents were cautioned by the auditors that the deficiency could lead to the termination of the company's approval and advised also to contribute additional capital to the company to cure the deficiency.[3]

Respondent Vester prepared management's response to the audit finding in which he stated that $906, 324.00 of capital was contributed by Respondents, but did not mention the SBA loan . Respondent also prepared three Corrective Action Plans, tellingly describing in the Corrective Action Plans the proceeds from the SBA loan as "working capital," "contributed capital," or "paid-in capital," but not showing a corresponding entry for the loan as a liability. In addition to the fact that misclassifying the SBA "loan proceeds as paid-in capital was inconsistent with GAAP and FHA program requirements," counsel notes that "respondents did not provide [the auditor] a complete description of the SBA loan until 2017" and " [d]ue to Respondents' misrepresentations to their auditor, which are the same misrepresentations they made to HUD, the auditor was unable to substantiate Respondents' assertions as to the SBA Loan, the Kevin Vester Plan, or the presentation of the Vinson Mortgage's financial statements." Gov't Brief at 27. Respondents' failure to provide the information was a violation of their obligations under GAAP.

Counsel argues that Respondents, as participants or principals in covered transactions, here, owners of a company that originated FHA-insured mortgages, are subject to debarment. See 2 C.F.R. §§ 180.150, 180.970, and 180.980. Further, because of Respondents' decision-making

[3] Later, the company was referred to the Mortgagee Review Board because of its failure to submit acceptable audited financial statements. The Board determined that the company's FHA approval should be withdrawn, whereupon the company appealed the Board's decision to the Office of Hearings and Appeals (OHA). OHA upheld the Board's decision. The company then filed a petition for Secretarial review of the OHA's decision. In a decision issued January 9, 2018, the Secretary's designee affirmed the OHA's decision.

positions in the company and their knowledge of and acts of wrongdoing on behalf of the company, the improper conduct of the company may be imputed to Respondents.[4] Similarly, Respondents' misconduct may be imputed one to the other. See 2 C.F.R. § 180.630.

Cause for debarment exists based on Respondents' misrepresentation of the SBA loan and on their submission of misleading financial statements, discussed above. The statements were not presented fairly nor in accordance with GAAP and the HUD-OIG Guide, as required by HUD. Counsel also argues that Respondents' actions with respect to the Second FY 2013 Audit and the FY 2014 Audit were willful in that they knew their responses to HUD's questions arising from the audits and the SBA loan were false. Respondents' purpose in providing false and misleading information was to persuade HUD not to withdraw the company's FHA approval. Also, as previously mentioned, as a condition for maintaining its FHA approval, the company was required to comply with HUD Handbook 4060.1 Rev.-2 and the HUD-OIG Guide regarding submitting "acceptable" financial statements and corrective action plans. Counsel adds also that the violations by Respondents of HUD regulations and other authorities governing the preparation and submission of financial statements was willful, thereby making Respondents subject to debarment under 2 C.F.R. § 180.800(b). In this regard, Respondents' misrepresentations in their financial statements affected the integrity of the proceedings before the MRB and the recertification decision of HUD's Lender Recertification Division. Counsel argues that Respondents' conduct described here, including the misleading statements discussed previously, also affected their present responsibility, pursuant to 2 C.F.R. § 180.800(d).[5]

Counsel rejects, as a defense, Respondents' argument that the presentation of the SBA Loan in the company's financial statements satisfied GAAP, specifically ASU 2013-04 (Topic 405), thus

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[4] The company (Vinson Mortgage Services, Inc.) has not been named in a debarment action in which its culpability was determined. *See, e.g.*, 2 C.F.R. § 180.805. Nonetheless, the company's FHA lending approval was withdrawn, based on allegations similar to those raised in this matter. That withdrawal decision was later affirmed. For that reason, this decision will limit imputing the company's conduct to the Respondents to only those issues that are identical to those in dispute in this matter and which were settled in the OHA hearing before the ALJ and later affirmed in the Order on Secretarial Review issued on January 9, 2016 in Case No. 16-JM-0076-MR-008.

[5] In the interest of clarity, it should be pointed out that 2 C.F.R. §180.800(d) provides for debarment for "[a]ny other cause of so serious or compelling a nature that it affects your present responsibility." Because counsel proposes §180.800(d) as a basis for Respondents' debarment, citing the same violations that he argued earlier justify Respondents' debarment under §1800.800(b), it is not readily apparent what the "other cause" may be. If the same causes, here submission of unacceptable financial statements, misleading statements, misclassification of the SBA loan, etc., that were invoked to propose Respondents' debarment under 2 C.F.R. §180.800(b) are used to debar Respondents under §180.800(d), it would effectively render the word "other" in the cited regulation as, at best, an inconvenient superfluity to be ignored. No authority was found that supports such an approach.

there is no cause for debarment. By raising Topic 405 as a defense, Respondents implicitly concede that the company was a borrower on the loan, because Topic 405 applies only when there is joint and several liability for a loan. Also, "Topic 405 mandates the recognition, measurement, and disclosure of the joint and several liability," which is missing from the Second FY 2014 Audit and the FY 2014 Audit. Likewise, the "makers' agreement" is unhelpful in Respondents' Topic 405 defense because the company is not a party to the agreement, only the two Respondents. Respondents' failure to make certain disclosures required by Topic 405, including a description of how the liability arose, the total outstanding amount of the debt, and the carrying amount of the company's liability also is unhelpful to their defense.

Counsel also dismisses as "deficient" Respondents' defense that HUD was aware of the nature of the transaction related to the SBA loan. HUD's auditors, because of a lack of information from Respondents, were unsure whether the SBA loan proceeds might be the source of the funds for the "capital contribution," so described by Respondents in the two audits. Counsel also dismisses as Respondents' misstating the issue, their argument that accounting issues based on differences in interpreting GAAP is not a cause for debarment. The cause for debarment, according to counsel, is Respondents' misrepresentation to HUD that Respondents made a contribution of over $900,000.00 to the company. In truth, those funds were from the SBA loan, a loan for which Respondents along with the company were liable.

In a supplemental filing, the Government challenges some of the claims and assertions made by Respondents in their Pre-Trial Statement. First, counsel distills the issues to be decided as whether "Respondents' material representations to HUD" provide a basis for debarment and whether Respondents lack present responsibility, answering both questions in the affirmative. In more specific detail, counsel argues that Respondents' description of the SBA loan in their Pre-Hearing Statement is inaccurate to the extent they assert that Vinson Mortgage Services was not an obligor on the loan. Counsel adds that Respondents' position was rejected by the administrative judge in a related case, *In re. Vinson Mortgage Services, Inc.,*. 16-JM-0076-MR-008 (August 14, 2017). Additionally, counsel rejects Respondents' argument that the company's assets were not pledged to the bank, finding support for his position in the UCC-1 financing statement filed by Fortune Bank, the lender, and in the court's decision in *In re. Vinson Mortgages Services, Inc. supra.*

In like manner, counsel also makes short shrift of Respondents' argument that they

disclosed and accounted for the SBA loan in the company's 2013 and 2014 financial statements. Counsel posits that there is no credible evidence to support Respondents' argument and distinguishes or dismisses the cases cited by Respondents in support of their position. Counsel rejects Respondents' attempts to blame others for the deficiencies in the financial statements, noting that Respondents were the ones responsible for the statements being in conformity with GAAP, not the auditor. Finally, Respondents' argument that the adjusted net worth computations are outside the scope of the Notice is rejected by counsel based on the provision in HUD Handbook 4060 ¶ 4.4(A)(1)(b) that the adjusted net worth statement is considered part of the audited financial statements and 24 C.F.R. § 202.7(b)(3)(A) which provides for "an analysis of the mortgagee's net worth."

In reviewing the aggravating factors under 2 C.F.R. §180.860,[6] counsel argues that Respondents' unwillingness to provide truthful information, including information related to the SBA loan, caused HUD harm. Among other aggravating factors raised by counsel were the planning and duration of the wrongdoing, beginning with Respondents' submission of the 2014 audit in March 2015; Respondents' failure to accept responsibility for their wrongdoing or to recognize the seriousness of their misconduct; Respondents' lack of cooperation with the responsible HUD entities during the investigation of this matter, taking almost two years to provide HUD with the requested SBA loan documents; the absence of internal control systems, as evidenced by Respondents' inadequate knowledge in preparing the consolidated financial statements at issue in this matter; and, despite adequate time to cure the problems associated with the financial statements, Respondents only recently informed their auditors of the true nature of the SBA loan.

Counsel concludes that Respondents' "unjustified failure to provide HUD with accurate financial documents" along with the aggravating factors noted above justifies a debarment of Respondents for three years,

RESPONDENTS' ARGUMENTS

Respondents, through counsel, in their Pre-Trial Statement argue that the government's case is frivolous as it is based on the difference in the parties' view of the proper treatment of an accounting transaction, i.e., Respondents' "contributed capital." As such, a "disagreement of

[6] Counsel states that there are no mitigating factors to be considered.

opinion is not a basis" for debarment.[7] Counsel also notes that the disputed transaction was audited and its treatment finds support in GAAP guidance (ASC 405) because of an agreement between Respondents.[8] That agreement provided that Respondents, not VMS, would be liable for repayment of the loan. In addition, Respondents along with Respondent Vester's wife mortgaged their personal property as security for the loan. Fortune Bank, the lender that made the SBA loan, recorded no liens against VMS. Accordingly, because of the agreement among three of the co-obligors (Respondents and Respondent Vester's wife) to repay the loan, "VMS should not report anything." Support for the practice of using a loan and contributing it as capital, according to counsel, besides GAAP and the independent public accountant's affirmation of the practice, is found in "IRS regulations and other common law doctrine." Resp. Pre-Trial Statement at 5.

Other factors that support VMS's recording of the transaction as contributed capital are (1) the transaction was based on a plan developed in late 2013 with the company's IPA and (2) the execution on June 30, 2014 of a stock purchase plan that Fortune bank not only knew of but also knew how Respondents would treat the loan proceeds, including to fulfill the requirements of the stock purchase agreement with the money wired directly to Respondents. As such, because VMS received none of the loan proceeds, the capital contribution was recorded correctly. Respondents also allege that HUD brought the instant action in bad faith to consume Respondents' limited resources especially because the hearing in the *VMS* case at that time was imminent. Further, Respondents note that HUD alleges now, though not in the Notice, that VMS failed to follow HUD guidelines with respect to its minimum net worth requirements. In response, Respondents state that they used the procedure found in HUD Handbook 4060.1 ¶4.5(B)(5) to correct the minimum net worth calculation. Also, the plan adopted to cure the minimum net worth deficiency was recommended by the company's independent auditors. The plan was included in the first 2013

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[7]As a procedural matter, Respondents argue that HUD has raised issues in its brief for the first time that go beyond the two issues they believe are set forth in the Notice; thus, the "additional issues" should be stricken, thereby avoiding a violation of Respondents' due process rights. Respondents also had indicated that they would file a motion in limine to "restrict presentation of any evidence on any additional issues." The motion was not filed. Notwithstanding that, however, and in view of the resolution of the related case, *In re. Vinson Mortgage Services, Inc,* today's decision is based solely on the issues propounded in the Notice. Also, Respondents filed a Request for an Evidentiary Hearing, opposed by the Government, which was renewed at the hearing. The request was taken under advisement pending resolution of the *VMS* case. In view of today's decision and the disposition of the *VMS* case, that request is denied.

[8]ASC 405-40—30-1 provides that "Obligations resulting from joint and several liability arrangements included in the scope of this Subtopic initially shall be measured as the sum of the following: (a) The amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors." Although not cited by Respondents, ASC 405-40-30-2 states that the "corresponding entry or entries shall depend on the facts and circumstances of the obligation."

audit report and executed on June 30, 2014.

Respondents also take issue with HUD's assertion that VMS assets were pledged, pointing out that no liens or mortgages were filed against the company's assets nor were the assets pledged, as legally defined. In like manner, HUD's recasting of VMS's net worth computation is flawed, resulting from HUD's failure to recognize that recasting of the challenged transaction as a loan means that "there are no assets pledged to the benefit of a third party." Resp. Pre-Trial Statement at 7-8. HUD's recasting of the transaction, because it is incorrect, should be ignored in favor of the net worth computation prepared by VMS's IPA. Counsel argues that the issue of the corrective action plan was not raised in the Notice; nonetheless, VMS did submit a written corrective action plan that remedied the deficiency in the company's net worth. In this regard, counsel asserts that as a result of the findings in the first 2013 audit, the company disclosed its plan to use the SBA loan to correct the minimum net worth deficiency. This disclosure was made in the corrective action plan for 2014 and the second 2013 audit. Counsel notes further that VMS's IPA prepared the financial statements, the footnotes, the statement of minimum net worth, and stated that the $906,000.00 from Respondents was properly recorded as a capital contribution.[9]

FINDINGS OF FACT

1. Respondents were principals of a mortgage company, VMS, that was a HUD-approved Title II lender.
2. As a requirement for recertification as a HUD-approved mortgagee originating FHA-insured loans, VMS annually had to submit to the Secretary of HUD copies of its audited financial statements.
3. Pursuant to the applicable regulation at 24 C.F.R § 202.5(g), the audited financial statements must be submitted within 90 days of the end of the mortgagee's fiscal year.
4. Respondents submitted the audited financial statements for VMS for FY 2013 and FY 2014, the two years at issue in this proceeding, in 2016 and 2015, respectively.[10]

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[9] Respondents add here that HUD's case relies heavily on GAGAS and HUD Handbook 2000.04, which are for use by IPA's, not by the regulated lenders such as Respondents who are not accountants or independent auditors. For clarification, it should be pointed out that the IPA's testimony at the OHA hearing is not in accord with Respondents' claim that the loan proceeds were properly recorded. The IPA testified that there was still uncertainty regarding the proper treatment of the loan proceeds as contributed capital.

[10] The 2013 audit report was resubmitted because of inadequacies in its preparation noted by HUD. The report was later

5. The statements must be accompanied by the auditor's report that includes a schedule of findings.
6. In the report submitted in connection with VMS, the auditor made a finding of material noncompliance by VMS with the regulatory minimum adjusted net worth requirement for FY 2013.
7. The net worth shortfall required VMS to submit to HUD a corrective action plan that would satisfy the regulatory requirement, thus allowing the company to maintain its status as an approved HUD mortgagee.
8. In the corrective action plan, Respondents stated that they would "obtain SBA loans to provide funds for capital contribution from new shareholders."
9. VMS in September 2014 applied for and received an SBA guaranteed loan for $932,000.00 from Fortune Bank.
10. Respondents signed the loan documents in both their individual and corporate capacities along with Respondent Vinson's wife.
11. All three and VMS pledged their assets as collateral for, and acknowledged their joint and several liability on, the loan.
12. Respondents executed a document more than two years later (the "Makers' Agreement") which stated that they only (i.e., not including VMS) were liable for repayment of the loan. Neither Fortune Bank nor VMS signed that document nor any other document acknowledging Respondents' declaration.
13. The SBA loan provided that no amendment to the loan agreement is effective unless in writing and signed by the party charged by the amendment.
14. Respondents, in their corrective action plan, did not inform HUD, as required by HUD regulations, that the cash infused into VMS came from the SBA loan.
15. The original FY 2013 audit filed by VMS was rejected by HUD on March 15, 2015.
16. Respondents submitted a recertification package which, on HUD's instructions, was to include a corrective action plan for the adjusted net worth noncompliance and information on the amount and source of the funds to remedy the noncompliance.
17. HUD rejected the second corrective action plan and thereafter the MRB issued the Notice of Violation for the company's failure to provide acceptable audited financial statements and

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resubmitted and for ease of reference is described in this proceeding as the "Second FY 2013 Audit."

supplemental reports in its FY 2013 recertification submission.

18. In VMS's response to the NOV submitted by Respondent Vinson on behalf of the company, the proceeds from the SBA loan were treated as a cash equity contribution from Respondents.
19. The financial statements associated with the FY 2014 audit also referred to the Respondents' contribution as paid-in capital.
20. Respondents did not inform their auditors that the contributed capital was from the proceeds of the SBA loan.
21. In total, Respondent submitted three corrective action plans (a plan for the original FY 2013 audit, the second FY 2013 audit, and the original 2014 audit), none of which resolved the issues raised in the NOV.

CONCLUSIONS

1. Respondents were principals or participants (as defined in 2 C.F.R. §§ 180.995 and 180.980, respectively) in covered transactions (see 2 C.F.R. §§ 180.200 and 180.970) by virtue of their ownership and control of VMS, a non-supervised mortgagee, approved by HUD to originate FHA-insured loans.
2. HUD requires a mortgagee to be recertified annually to remain eligible to continue originating FHA loans.
3. As part of the recertification process for the current year, mortgagees are required to submit their audited financial statements for the prior year within 90 days of their fiscal year-end along with providing other information requested by HUD. See 24 C.F.R. § 202.5(g).
4. Further, as a non-supervised mortgagee, VMS was obligated to provide HUD any financial information HUD required. Pursuant to the regulation, the financial information provided by VMS had to be prepared in accordance with Generally Accepted Accounting Principles (GAAP). See 24 C.F.R. § 5.801(b)(1).
5. In the financial statements submitted to HUD, VMS treated the SBA loan proceeds ($932,000) as paid-in capital, not as a loan, thus a liability. The financials falsely reflected each Respondent's half share of the loan as an equity contribution. Treating the loan as paid-in capital did not accord with GAAP and materially distorted the true picture of the

company's adjusted net worth. (Fortune Bank previously had distributed the loan proceeds not directly to a VMS account, but in two equal shares to Respondents' personal bank accounts).

6. In the first instance, it was Respondents' responsibility to ensure that the financials were prepared consistent with GAAP.
7. The fact that VMS received none of the loan proceeds, as Respondents state, does not mean that the loan was recorded properly. It is undeniable that the loan remained an outstanding obligation of the company.
8. Similarly, Fortune's knowledge of how the loan proceeds would be treated by Respondents, as asserted by Respondents, did not change the character of the original transaction - - it remained an obligation of the co-obligors, including VMS.
9. Respondents' reference to Topic 405 is unhelpful in their attempt to justify their treatment of the loan, because of their failure to make the disclosures required by Topic 405, including, e.g., how the liability arose, total outstanding amount of the debt, etc.
10. The ignoring of the source of Respondents' contribution was a deliberate attempt to mislead HUD with respect to the true nature of their contribution, that is, that the contribution was derived from the loan proceeds. This accounting sleight-of-hand was contrived by Respondents in an attempt to ensure recertification of VMS as an approved lender.
11. Respondents' actions followed HUD's finding that VMS was noncompliant with HUD's adjusted net worth requirement and in the face of possible administrative sanctions by the Mortgagee Review Board (MRB).[11]
12. In Respondents' struggle to satisfy the minimum net worth requirement for VMS following HUD's rejection of Respondents' FY2013 submissions, and later the FY 2014 financials and corrective action plans for VMS, they intentionally submitted financial statements that contained false information or errors or that were not consistent with GAAP or HUD Handbook 4060 REV.2.

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[11] The conclusion here is condensed in light of the fact that VMS's appeal of the MRB's withdrawal decision in the *VMS* case was denied by the ALJ after a three-day hearing and the denial was affirmed. The issues in the OHA case, as evidenced in the trial record, were fully heard and contested and mirror those before this tribunal in the instant case. The difference between the OHA case and the case at bar is that the named Respondents are not the same in both cases. The difference is immaterial because the transgressions alleged in both cases were committed by Respondents, even though, as required by HUD regulations, in the OHA case the violations were charged to VMS. For that reason, the relevant findings and conclusions in the OHA Initial Decision and Order and in the Order on Secretarial Review are incorporated by reference in today's decision.

13. It borders on the fictional for Respondents to argue that VMS, even though a named borrower on the loan with its assets pledged[12] as security for the loan, was not liable as a co-borrower with Respondents for repayment of the loan. Or that the agreement between them that they, i.e., Respondents, only would be liable to repay the loan (an agreement not approved by the bank, as required by the loan documents) relieved VMS of its repayment obligations. The plain purpose of Respondents' intentionally erroneous treatment of the loan transaction, as reflected in the financial statements submitted to HUD, was to "convert" the loan proceeds into equity to bolster VMS's assets and, thus, the company's chances for recertification as an FHA-approved lender.
14. Respondents' argument that HUD's raising issues in its Pre-trial Brief that were not included in their respective Notices violates their due process rights finds no support in the record. Arguably, the "issue of the corrective plan [*qua* issue] was not contained in the Proposed Notice of Debarment," as Respondents allege. The short answer here is that reference by the Government to the corrective plan was not raised as an issue separate and apart from the two issues identified in the Notice. The matter of the corrective plan was introduced by the government as evidence, not as a separate issue, in support of the allegations in the Notices of Respondents' "participation in VMS' submission to HUD of a management's response" and their "participation in VMS' submission of audited financial statements that contained errors or false information."
15. The government was entitled to introduce relevant evidence to prove its case. Moreover, the government filed its brief on May 22, 2017. Respondents filed their brief on August 15, 2017. As such, because of the oft-repeated references to the corrective plans in the government brief, Respondents were clearly on notice that all their submissions were potentially subsumed in the reference to errors or false information, even if, *arguendo,* the Notices could have provided more specific details describing the "errors or false information." *Cf., e.g.*, the Initial Decision and Order in the *VMS* case, *supra,* at 10, where the court, faced with a similar objection by VMS, observed that "due process is flexible and calls for such procedural protections as the particular situation demands," *citing Matthews v.*

[12] Respondent's argument that there was no pledge of VMS's assets because there was no lien or mortgage filed against the company's assets is, at best, misbegotten. As the government correctly argued, the UCC-1 filing served to perfect Fortune Bank's security interest.

Eldridge, 424 U.S. 319, 334 (1976) (quoting *Morrissey v. Brewer*, 408 U.S. 471, 481 (1972).

16. Respondents' deliberately false representation of the SBA loan along with financial statements prepared to reflect a false picture of the company's financial position provides cause for Respondents' debarment pursuant to 2 C.F.R. § 180.800(b).
17. HUD has met its burden of proof through the overwhelming evidence of Respondents' willful conduct as detailed here and in the entire record in this matter. See 2 C.F.R. § 180.850(a).
18. The courts have repeatedly held that "[d]ebarments and suspensions are serious sanctions that should only be utilized for the purpose of protecting the public interest and may not be used as punishment." *In the Matter of Lisa Burns*, 2011 HUD ALJ LEXIS 24 (December 29, 2011). Also, the test for determining whether a proposed sanction is warranted is present responsibility, which may be inferred from past acts. *Schlesinger v. Gates*, 249 F.2d. 111, (D.C.Cir.19a
19. Pursuant to 2 C.F.R. § 180.860, the Debarring Official may consider the aggravating and mitigating factors present in each case. As a mitigating factor, I considered the fact that Respondents have been professionals in the mortgage lending business for many years and, as far as the record goes, have not been cited for professional misconduct.
20. As aggravating factors, I considered, *inter alia*, the potential harm that could have come to the insursance fund and participants in the Title II program if Respondents' misconduct went unchecked; Respondents' active participation in the planning, initiation, and carrying out of the scheme to represent falsely the SBA loan as a capital contribution; and Respondents' failure to accept responsibility for their actions.
21. In considering whether to debar a respondent, and what period of debarment is appropriate, in addition to the mitigating and aggravating factors, 2 C.F.R. § 180.125(c), in pertinent part, provides that "An exclusion is a serious action that a Federal agency may take only to protect the public interest. A Federal agency may not exclude a person or commodity for the purpose of punishment." In offering guidance on how long a debarment may last, 2 C.F.R. § 180.865(a) states that "your period of debarment will be based on the seriousness of the cause(s) upon which your debarment is based. Generally, debarment should not exceed three years. However, if circumstances warrant, the debarring official may impose a

longer period of debarment."

22. The seriousness of Respondents' wrongdoing cannot be overstated. For that reason, a period of debarment is necessary, not only for the protection of the public interest but to ensure that Respondents can conform their conduct for an appropriate time to the standards of a person who is presently responsible.
23. HUD has a responsibility to protect the public interest and take appropriate measures against participants whose actions may affect the integrity of its programs. *See generally*, 2 C.F.R. § 180.125.
24. HUD cannot effectively discharge its responsibility and duty to the public if participants in its programs or programs that it funds fail to act responsibly.

DETERMINATION

Based on the foregoing, including the Findings of Fact, Conclusions, and the administrative record, I have determined, in accordance with 2 C.F.R. §§ 180.870(b)(2)(i) through (b)(2)(iv), to debar Respondents for three years from the date of this Determination. Respondents' "debarment is effective for covered transactions and contracts that are subject to the Federal Acquisition Regulation (48 C.F.R. chapter 1), throughout the executive branch of the Federal Government unless an agency head or an authorized designee grants an exception."

Dated: 3/13/18

Craig T. Clemmensen
Debarring Official

CERTIFICATE OF SERVICE

I hereby certify that on this 14th day of March, 2018, a true copy of the DEBARRING OFFICIAL'S DETERMINATION was served in the manner indicated.

Tanya Domino
Paralegal/Debarment Docket Clerk

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