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FULL COMMITTEE HEARING ON OVERSIGHT OF THE SMALL BUSINESS ADMINISTRATION AND ITS PROGRAMS

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES
HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

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FULL COMMITTEE HEARING ON OVERSIGHT OF THE SMALL BUSINESS ADMINISTRATION AND ITS PROGRAMS

Thursday, November 19, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 10:00 a.m., in Room 2360 Rayburn House Office Building, Hon. Nydia Velázquez [chairman of the Committee] presiding.

Present: Representatives Velázquez, Dahlkemper, Schrader, Nye, Altmire, Ellsworth, Graves, Bartlett, Akin, King, Fallin, Buchanan, Luetkemeyer, Thompson and Coffman.

Chairwoman VELÁZQUEZ. This hearing is now called to order.

In the 111th Congress, the House has made an unprecedented commitment to transparency. Under the Speaker's direction, the House has adopted Rule 11 which requires quarterly hearings on fraud, waste, abuse, and mismanagement of programs under committee jurisdiction.

I am proud to say that the Small Business Committee has gone above and beyond that requirement. Since January, we have conducted no fewer than 16 oversight hearings. Today's discussion marks the third in a series we have held with GAO and SBA this year and give us an opportunity to gauge the state of the agency's program.

These hearings are an important took for measuring progress and gathering information. In the past, they have been enormously useful not just for spotting SBA problem areas, but also for solving them.

In July, we met to examine disaster loans, a program that has been mired in controversy sine Hurricane Katrina. That discussion generated a number of recommendations for improvement and, importantly, was the impetus behind the Small Business Disaster Readiness and Reform Act introduced by Representative Parker Griffith.

SBA programs have always been a lifeline for struggling small firms. In light of the current downturn, they are more important than ever. These are initiatives that encourage greater competition in the marketplace and yield significant returns on the taxpayer dollar.

Even more importantly they help create jobs. Small firms generate roughly 70 percent of new positions, and investment in these ventures is a downpayment for job growth. That is why it is so important for SBA's program to be running at full capacity.

In past oversight hearings, however, GAO has shed light on some struggling areas in the agency's contracting portfolio. At our oversight hearing in May, GAO helped us identify considerable fraud within the HUBZONE program. In some cases, big businesses had gamed the system to win small business contracts. In other instances, firms in wealthy neighborhoods had posed as struggling ventures with HUBZONE addresses.

In all cases, we knew just what we were looking at: the fleecing of America's entrepreneurs. And, unfortunately, it seems to be happening to some of our most vulnerable instances. Fraud within the federal marketplace is never an acceptable thing, but it is particularly troubling when it comes at the expense of our veterans. The Disabled Veterans Contracting Program was established as a means of empowering these men and women.

With unemployment for severely disabled soldiers at 85 percent, it is particularly important today. Entrepreneurship offers a kind of financial independence that other livelihoods cannot. We need to be sure it remains a viable option for our veterans, the men and women who have served our country so well. These brave Americans have more than earned their shot at entrepreneurship.

And yet we know we now have reason to believe that disabled veterans program is being exploited by an unscrupulous few dishonest businesses that have cheated out veterans of countless opportunities. This sort of abuse is more than a simple injustice. It is criminal, and it needs to be addressed immediately, not weeks or months down the road.

The Committee is not only going to look for ways to support the disabled veterans contracting program, but to hold these individuals accountable who have sought to game the system at the expense of our nation's veterans.

In times of economic turmoil, small firms have always relied on the SBA. Even if it means tremendous uncertainty, the agency has stood as a beacon of stability. It is critical that it continue to play that stabilizing role. Just as our economy is counting on small businesses to lead the recovery, small businesses are counting on SBA for strength and support. We cannot afford to let them down.

I would like to thank our witnesses, including Administrator Mills, for being here this morning, and I would also like to recognize Mr. Kutz for helping to compile today's reporter. GAO has been an invaluable resource to this Committee in the past, and I am grateful for their hard work and dedication to transparency.

With that I will yield to Ranking Member Graves for his opening statement.

Mr. GRAVES. Thank you, Madam Chair, and thank you for holding this hearing today on oversight of small business, the SBA and its programs, and I look forward to hearing the insight of all the witnesses today.

Thank you, Administrator, for coming in. I appreciate it.

The Small Business Administration oversees a variety of programs, including procurement initiatives designed to increase growth of small businesses. This Committee has a responsibility to insure that these programs operate to the benefit of small businesses, including the ones directed at specific groups, such as the service disabled veterans.

The Small Business Act requires that small businesses receive their fair share of opportunities to provide goods and services in the $434 billion federal contracting marketplace. Congress then decided that within this segment of small businesses, those owned by service disabled veterans deserve extra assistance for the sacrifices that they have made to defend this country. No one can deny that this assistance is deserved.

It is then troubling to find out that the program is subject to fraud. The investigation that will be discussed at this hearing reveals that some firms are not performing the contracts. Instead, they are having the goods and services supplied by large businesses.

In other cases, businesses are not owned by service disabled veterans. The underlying problem, as it was with the HUBZONE program is the ability of small businesses to self-certify eligibility for the program without any independent checks by the SBA.

By itself the fraud would be problematic. However, it is more troubling that firms ineligible for the program then deny firms that are eligible for contracts. The firms denied contracts are those owned by individuals who made significant sacrifices in defending this country, and it is simply unacceptable.

I look forward to hearing the testimony today and learning about the steps that are being taken to address this problem when it comes to the fraud. If those actions do not prove successful in insuring that service disabled small business owners benefit from the program, then I would like to see aggressive legislative action taken to do so.

Again, Madam Chairman, I appreciate you having this hearing, and I look forward to the testimony

Chairwoman VELÁZQUEZ. I now yield to Mr. Nye. He is the chairman of the Contracting and Technology Subcommittee.

Mr. NYE. Thank you.

I would like to thank Chairwoman Velázquez and Ranking Member Graves for holding this important hearing today. Administrator Mills and Mr. Kutz, I would like to thank you both for being here as well. I know you have been extremely busy.

Administrator Mills, you just came on to lead the SBA this spring, and unfortunately it seems you have stepped into a mess of fraudulent contracting and abuse of federal American taxpayer funds. I hope you will take on this issue as a top priority and that this hearing will be helpful for all of us to move forward on finding a solution to this problem.

It is my priority as chairman of the Contracting and Technology Subcommittee to insure that contracts, especially those set aside for our service disabled veterans who have served and sacrificed for our country, are in fact given to small business owners.

At the first hearing I held in my Subcommittee in March of this year, before you were the Administrator, I addressed the federal agencies on the issue of meeting their contracting goals for service disabled veterans with recovery act funds. You and I spoke a few weeks ago, Administrator Mills, in my office, and you showed me a very promising report card on the progress toward meeting our federal agency contracting goals, and according to those numbers, it looked like the goal of three percent for our service disabled vet-

eran companies was being exceeded by nearly a full percentage point.

However, on the basis of this report and today's testimony, I am deeply concerned that those promising numbers could come with a very large asterisk, and I am looking forward to hearing both of your testimony today and to getting to the bottom of this serious problem.

I yield back, Madam Chairwoman.

Chairwoman VELÁZQUEZ. Is there any member from the minority side that wishes to make an opening statement? If not, we are going to proceed with the witnesses.

And it is my pleasure to welcome the Honorable Karen Mills. She was sworn in April 6, 2009, as the 23rd Administrator of the U.S. Small Business Administration.

Prior to being confirmed as SBA Administrator, Ms. Mills most recently served as the President of MMP Group in Brunswick, Maine.

The SBA helps small business owners and entrepreneurs secure financing, technical assistance, training and fair contracts. And because we have only two witnesses, I am going to be flexible with the five minute rule. So welcome.

STATEMENT OF THE HONORABLE KAREN MILLS

Ms. MILLS. Thank you, Madam Chair.

Chairwoman Velázquez, Ranking Member Graves, distinguished members of the Committee, again, it is an honor to testify before you. Thank you for your continued efforts to help America's small businesses survive, grow, and lead us out of this recession.

I want to thank the Chairwoman for speaking at yesterday's Small Business Financing Forum--that we held with Secretary Geithner at the Treasury. You said two things at that meeting that I really found resonated. First, you said access to capital equals access to opportunity. That statement rings true given our efforts to help small businesses find the credit that they need to create job.

And you also said at this conference that this conference proved that small business is not an afterthought. I think this is true not only for you, but for all the members of the Committee and the administration. With the help of this Committee, we are insuring that SBA programs provide maximum value to small business owners.

At the same time, and this is really the subject that we are here on today, we are committed to insuring that taxpayer dollars are spent wisely, transparently, and effectively, with proper risk management and oversight.

The Recovery Act is a strong example as a result of the 90 percent guarantee and the lowered fees in our two flagship programs, we have engineered a turnaround in SBA lending. Briefly, the SBA has supported more than $14 billion in lending to small business since the Recovery Act was passed, with recent months at levels that we have not seen since 2007. We are above the 2008 mark.

Weekly loan volumes have risen 75 percent compared to the weeks before the Recovery Act was passed, and we have here in the back this report card what we describe as these numbers. Most importantly, we have 1,250 lenders offering SBA loans who had not made a loan since October of 2008, and about half of them had not

made a loan since 2007. This means more points of access to capital for our small businesses, which is an important priority for us.

So I want to thank the Committee for all that you did to pass the Recovery Act. Our feedback from entrepreneurs, from small business owners, the lending community has been extremely positive. As the Chairwoman may have heard yesterday, the lenders said that these loan enhancements help provide a critical lifeline for small businesses that are having trouble finding credit. We are going to continue to monitor these programs using a robust risk management framework that we established under the rules of the Recovery Act.

More broadly, the team at the SBA continues to address outstanding and emerging areas of risk in a systematic way, and we are focusing on the very helpful recommendations of the GAO and of our IG. I am pleased to say one of the things I committed to you last time is that we are going to take all of those recommendations and work through them. We have reduced open findings from our Inspector General by 47 percent over the past 18 months, and in the past quarter alone we have reduced the number of overdue open recommendation from 97 to 53, I am taking this very seriously.

We are pleased also to have our new Inspector General on board, Peggy Gustafson. Her work will help to continue to insure that the SBA is transparent, it is efficient, and it is meeting the needs of America's small business.

In addition, the SBA remains committed to strengthening our lender oversight activities to eliminate fraud, waste, abuse and mismanagement. Given the exposures our loan guarantees represent to the taxpayers, my team's goal is to insure that we have robust credit risk management system that includes oversight and portfolio monitoring.

On the subject that the Chairwoman and Ranking Member Graves raised today, and I know we're going to talk about, the SBA is acutely aware that America is fighting two wars. Thousands of our veterans are returning home. I want to thank GAO for the report that they just released. We must make sure that service disabled veterans have ample opportunities to start and grow a business, including the opportunity to access federal contracting.

Since I first came on board in April, we have begun an new collaboration with the Veterans Administration leadership on the critical issue of access to accurate and transparent data regarding who is a service disabled veteran. Both the SBA and the Veterans Administration have made this a top priority.

Second, we are working to make sure there is accountability in this program. It is a subject we are going to talk about today. The ten businesses described in this report have already been referred to our IG. Make no mistake, if they are found to be noncompliant, they will be debarred.

Overall we will continue to work with the VA to insure that we have a system that works for veterans and is responsible to taxpayers.

Finally, per the Chair's interest at our last hearing, I just want to mention that we sent three reports to Congress regarding our efforts with disaster preparedness and assistance: the disaster recov-

ery plan, the 2009 annual report on disaster assistance, and the reports on federal contracts awarded as a result of major disasters.

I should also mention that we have held two disaster trainings for our field staff, and on a related note, we released and heavily promoted--and I personally spent a long time promoting--an H1N1 flu preparedness guide. It has been very well received by thousands of small business owners. It describes how they make a plan for their businesses in case they have an issue with H1N1.

Overall my vision is that the SBA will continue to operate in a way that will meet the expectations of Congress, small businesses, and the American taxpayer. I look forward to working with the distinguished members of this Committee to make that happen. I welcome any questions, concerns, and comments about any of our programs or efforts.

Thank you.

[The prepared statement of Ms. Mills is included in the appendix.]

Chairwoman VELÁZQUEZ. Thank you, Ms. Mills.

Our next witness is Mr. Greg Kutz. He is the Managing Director of Forensics Audits and Special Investigations at GAO. The FSI Unit investigates waste, fraud and abuse related to government programs and taxpayers' dollars.

FSI has investigated abuses of Hurricane Katrina relief dollars, border security, and overtime and minimum wage complaints, among other topics.

Welcome, sir.

STATEMENT OF GREGORY KUTZ

Mr. KUTZ. Madam Chairwoman and members of the Committee, thank you for the opportunity to discuss the service disabled, veteran-owned small business program. This program honors service disabled veterans for their incredible service and sacrifice by providing contracting opportunities. Today's testimony highlights the results of our investigation into allegations of fraud and abuse in this program.

My testimony has two parts. First, I will discuss cases of fraud and abuse, and second, I will discuss fraud prevention controls.

First, we received over 100 allegations of fraud and abuse for this program, and I will note that we stopped counting at 100. From these allegations we investigated ten cases which often included a number of affiliated firms and joint ventures. For these ten cases, we found that they received $100 million of service disabled sole source and set-aside contracts using various fraudulent schemes.

These case studies also received over $300 million of 8(a), HUBZONE, and other federal contracts.

Key program eligibility requirements include, first, firms must be at least 51 percent owned by one or more service disabled veterans.

Second, the firm's day-to-day operations must be controlled by the service disabled veteran or their caregiver.

Third, the firms must perform 15 to 50 percent of the work.

And, fourth, the firm must be a small business.

Examples of what we found include, first, a firm whose owner was not a service disabled veteran. This firm fraudulently received

$7.5 million of FEMA contracts for Hurricane Katrina and Rita trailer maintenance.

Second, a firm that subcontracted 100 percent of its work to an international corporation headquartered in Denmark with annual revenues of $12 billion. That is right, 12 billion with a B.

Third, a construction firm with no assets and no employees passing through work to an ineligible firm. The owner of this shell company lived 80 miles away and managed a restaurant in another city.

And, fourth, another shell company with, again, no assets and no employees passed through a $900,000 contract to an ineligible firm that delivered and installed the furniture. The monitor shows the Shell company address which is the owner's home. The owner of this company was actually a full-time contract employee at MacDill Air Force Base, which awarded him this contract.

What is discouraging about many of these cases is that contracting officials were actively involved. For example, for the MacDill Air Force Base furniture case, contracting officials were aware of the shell company and that the owner was actually a full-time contract employee at the base. The base Director of Business Operations also told us that MacDill had about $14 million of service disabled sole source and set-aside contracts in 2008, and that 90 percent of the firms that received these contracts were front companies for large businesses.

Other contracting officials were not quite so candid. The monitor shows a picture of portable toilets at Fort Irwin in Texas. As you can see, the name of the non-service disabled firm is blocked off from the picture. However, it is clear that in cases like this, contracting officials know exactly who is providing the service.

Moving on to my second point, there are no fraud prevention controls in place for this program, and as our case studies show, even individuals that lie about whether they are service disabled veterans can receive millions of dollars of contracts. The only thing resembling a control for this program is the SBA bid protest process.

In fact, for four of our ten case studies, SBA determined that these firms were ineligible for the program. However, these firms were not only allowed to continue the contracts they received fraudulently, but they also received new service disabled, set-aside, and sole source contracts. And in no cases did we see anybody, including SBA or any other agencies, that have suspended or debarred anybody for fraud and abuse in this program.

We are encouraged by the Veterans Administration's efforts to set up a process to validate the eligibility of firms doing business with the VA. We recommended that SBA, VA and OMB look at the feasibility of expanding this validation process government wide.

In conclusion, for just ten cases we identified $100 million of fraud and abuse. This multi-billion dollar small business program has no controls and no consequences for the few that are caught cheating. Unfortunately the victims of this fraud are legitimate service disabled veterans that play by the rules.

Madam Chairwoman, I applaud you and this Committee for supporting veterans today, and I look forward to working with all of you to help eliminate fraud and abuse from this important program.

That ends my statement, and I look forward to all of your questions.

[The prepared statement of Mr. Kutz is included in the appendix.]

Chairwoman VELÁZQUEZ. Thank you, Mr. Kutz.

Imagine being a veteran who is injured in Iraq or Afghanistan, yet despite your injuries you still manage to launch your own business. Then imagine finding out that you are losing out on contracts designated for veterans because a big company found out how to get around the rules.

What kind of message does that send to veterans in this country? They have got to stop. So, Mr. Kutz, I know that you talk about the fact that no fraud prevention controls exist for this program at SBA. Can you tell us a brief outline of what are some of the key elements of an effective fraud prevention program?

Mr. KUTZ. Yes, and I will give a highlight of it. There should be prevention controls at the beginning to make sure the people getting into the program are eligible. There should be monitoring controls that once you are in the program that front companies or shell companies are not passing through work, for example, to large businesses. And at the end of the day, those caught cheating need to have consequences: suspension, debarment, and prosecution.

So you need all three of those elements working together for an effective fraud program.

Chairwoman VELÁZQUEZ. Administrator Mills, based on what we just heard from GAO and recognizing the fraud that already exists in this program, would you develop a process to certify service disabled veteran owned small business?

Ms. MILLS. Madam Chair, I want to thank the GAO for this report. I think we completely agree and take with great concern this particular report and this entire area of fraud, waste and abuse. But particularly in this area of service disabled veterans, there are 300,000 of these veterans coming home from these two wars over the next several months. Twenty percent of them are unemployed after two years. These veterans over-index in entrepreneurship because they have great leadership.

Chairwoman VELÁZQUEZ. Ms. Mills.

Ms. MILLS. Yes.

Chairwoman VELÁZQUEZ. I just would like for you to answer my questions. Would you develop a process to certify?

Ms. MILLS. So, therefore, we are looking at the three approaches that Mr. Kutz just described. First, we need to make sure that we have the eligibility right, and I think that was your first point. So the eligibility has two prongs. One is are you a service disabled veteran? The second is are you a qualified small business?

We look at the qualified small business. We are partnering with the VA because the Veterans Administration holds the database that says whether or not they are service disabled veterans. They are the ones who do the first prong of the eligibility. So we are going to work with them to make sure we have a combined program that services the two pieces of the eligibility.

Then Mr. Kutz had a point about accountability, and that is the other piece that we are committed to. As I said, these ten particular examples cited by GAO have already been referred to the IG. We are committed to making sure we hold everybody accountable, and that has not been true in the past. That is a change, and we will commit to go after anybody who is noncompliant, and if they are not compliant, we will debar them.

Chairwoman VELÁZQUEZ. So, in essence, what you are saying to this Committee today is that SBA is going to develop a certified process, a process to certify disabled veterans.

Ms. MILLS. The SBA is going to provide a process to make sure we have the up front piece right in terms of eligibility and work with our partners to make sure we have the right input from the Veterans Administration. We're going to go after this accountability issue.

Chairwoman VELÁZQUEZ. Okay. Mr. Nye in his opening statement made reference to the fact that you had a meeting with him and was quite excited about the fact that the contracting goals for disabled veterans were achieved. So in light of this report, do you think that the SBA data could be overstated now?

Ms. MILLS. Right now the number is as Congressman Nye said. Our goal is three percent. Our achievement in the recovery act contracts is 3.8 percent. We are very pleased with that number, but we share, given this data, the exact same concern. We need to get to the bottom of this issue of fraud, waste, and abuse, and we need to make sure that we have a real achievement of three percent or greater.

Chairwoman VELÁZQUEZ. Yes. Mr. Kutz, what are your views on the matter of the contracting goals for disabled veterans being overstated as a result of the investigation?

Mr. KUTZ. I think they are overstated. I mean, for example, the pass-through to the company in Denmark would have counted as a success.

Chairwoman VELÁZQUEZ. Ms. Mills, the economic downturn is hitting Iraq and Afghanistan veterans particularly hard. There is, as you mentioned, an unemployment rate above 11 percent, and Congress never intended the SBA service disabled veterans program to award contracts to non-veteran companies who are less likely to hire veterans.

Given how high the veteran unemployment rate is, why hasn't the agency done a better job to make sure these contracts actually got to veterans?

Ms. MILLS.I just want to understand your question.

Chairwoman VELÁZQUEZ. In light of the report and given the fact that job creation is a challenge for our economy and given the fact that thousands of veterans are coming back from Iraq and Afghanistan, that there is a high unemployment rate, that you need to do a better job to make sure that the tools that we put in place, this Committee, the Congress, to address the issue of entrepreneurship among veterans coming back from Iraq and Afghanistan is achieved. This report reflects quite poorly in terms of making sure that those contracts that are awarded really go to the people that they were intended to.

Ms. MILLS. On the service disabled veteran contract piece, as I said, this is a very important and helpful report, but you are exactly right. These findings are unacceptable. We have to make sure that the eligibility--that businesses are eligible and that we hold them accountable if they are not.

In addition, we actually have a number of other programs specifically for service disabled veterans. One I want to highlight we announced last week. We are funding an expansion in our entrepreneurial area of a boot camp for service disabled veterans. It is built on a model that was done at Syracuse, an extraordinary program. We're expanding it to Florida State, to the University of Connecticut, to Purdue, to Texas A&M, and UCLA in the next year.

And one of the things we will be able to do with these boot camps and the veterans that we are working with is make sure they get into this pipeline of contracts and ensure they receive access to capital.

Mr. KUTZ. Madam Chair, could I comment on that real briefly?

Chairwoman VELÁZQUEZ. Sure.

Mr. KUTZ. I think one of the issues that you were getting at here is that these veteran firms are not getting the business. They are passing it through to either international corporations or large businesses who are not going to hire veterans. There is evidence to suggest that veteran owned firms hire veterans.

And I think your point is does this affect employment of veterans, and the answer in my view is yes.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Kutz, you mentioned that four of the ten case studies in your report were protested through the SBA bid process and found to be ineligible. What happened to these firms after they were found to be ineligible by SBA?

Mr. KUTZ. They continued with the contracts that they had been awarded through fraud and in several of the cases they continued to get new service disabled, sole source, and set-aside contracts.

Chairwoman VELÁZQUEZ. Were any of these firms recommended for suspension or debarment?

Mr. KUTZ. No.

Chairwoman VELÁZQUEZ. In your opinion, if there is enough evidence that will warrant such debarment or suspension?

Mr. KUTZ. Certainly suspension since the bar is much lower for suspension. Debarment is a very lengthy process, and it requires a lot of due diligence. Suspension, yes, if SBA themselves determined that someone was ineligible, one could assume that there was a chance they could suspend them at least for a period of time, and the point is to protect the rest of the government from the fraudsters.

Chairwoman VELÁZQUEZ. Mr. Graves.

And I will come back with more.

Mr. GRAVES. The examples that have been identified, has anything been done to any of those firms?

Ms. MILLS. Yes. All of those firms have been referred to our IG. We are recommending that they be investigated and if they are not eligible, that they be debarred. This is the highest standard--debarrement.

Chairwoman VELÁZQUEZ. Would you yield?

But how many of those ten that were found to be ineligible, Mr. Kutz, have gotten more contracts?

Mr. KUTZ. Virtually all of them, and some of them service disabled veteran owned contracts.

Chairwoman VELÁZQUEZ. So while the IAG, you refer them, and thank you for yielding, there is any action by SBA to prevent awards going to these companies that are ineligible?

Ms. MILLS. Madam Chair, you hit exactly on the right note, which is that this is the piece of it that we must prevent. The contracts come out of the various agencies, and they are let by these contract agents. We are determined to set a pattern where if they have been proven or referred to be ineligible, that there is accountability, and that clearly has not been the case in these, and that is unacceptable.

Chairwoman VELÁZQUEZ. Thank you for yielding.

Mr. GRAVES. Just to finish up with that, as far as at least with these examples, let's just use these examples right now. Are you letting other agencies know, you know, whether it is Defense Department or whoever the case may be, about these agencies and the problems obviously?

Are you doing that or is SBA taking the steps to make sure that the other agencies are aware of this and you are obviously investigating them and what is going on?

Mr. KUTZ. We have, yes. We sent letters not only to SBA but all of the affected agencies so they are aware of that, and our evidence and work support is available to SBA and the Defense Department, VA, whoever else was contracting with these people.

Mr. GRAVES. Is it a situation where they have to take the initiative to look at it? Are you making sure that they see that?

Mr. KUTZ. Well, we cannot force them to do anything. I mean, we send them the evidence, and it is their decision how aggressively they want to pursue it, and that is something you could potentially help us with.

Mr. GRAVES. All right. Thank you, Madam Chair.

Chairwoman VELÁZQUEZ. Mr. Ellsworth.

Mr. ELLSWORTH. Thank you, Madam Chair. I thank the witnesses for coming in.

Ms. Mills, I have heard you say "disbar" three or four times as the goal. I heard Mr. Kutz say "prosecution." Do you have an aversion to prosecuting these bad actors, or I have not heard you mention that word? Are you willing to go after and prosecute the bad actors in this?

Ms. MILLS. We are absolutely willing to go after the bad actors in any way within our power. Generally prosecution is handled by the Justice, but we are working very closely with the IG to go after them in any way within our power and collaborate with the GAO as well.

Mr. ELLSWORTH. I guess I am sitting here thinking about a book I read in college about the hot stove theory, that if you touch a stove it burns. It burns every time, and it burns hot. If some of these people, I suppose, just change the name of the company, go on and do something, another porta potty company and change the name and redo the thing over, a couple of people get some pretty

big fines and/or spend a little time in a camp or a federal prison, maybe they would think twice about doing that.

Mr. Kutz, who does it right? Who, in your opinion? You have done this a long time. You and I have had a lot of meetings together on this exact same subject. Is there anybody of the federal agencies that is doing it right, that has got the right screening policy, that has the right measures in place that you could point to and say, "These are the guys that get it. Everybody else needs to watch them"?

Mr. KUTZ. Well, I will use FEMA as an example, and in the Katrina and Rita disasters we did extensive testing and identified 22,000 case of fraud and abuse just for one program.

So we gave FEMA a whole series of recommendations and they implemented many of them. We went back and tested them again for Ike and Gustav, and they did much better. Now, they were not on apples and apples because they were much smaller disasters, but FEMA made significant improvements in their screening eligibility process to make sure if you gave them a bogus Social Security number, whether it was by Internet or by phone, they were not going to let you into the system. They were actually checking to see that the address you used was in a disaster zone, that you actually lived there before the disaster hit. They weren't doing that for Katrina and Rita.

So that's an example of oversight. We had numerous hearings on both the House and Senate side, and after several years positive improvements were made. So I think this is something that is not going to happen overnight, but we are certainly willing to work with you and the SBA to make this happen over a period of time.

Mr. ELLSWORTH. And the dollar figure I cannot remember. What was the billion dollar figure that you used that this added up to in small business?

Mr. KUTZ. Well, $100 million for these ten companies of just service disabled, but another three to $400 million of 8(a), HUBZONE, and other federal contracts, and so this is fairly significant just for these ten cases.

Mr. ELLSWORTH. Okay. So hundreds of millions stolen from us in these disabled veterans. Let's call it what it is. They've stolen it from us. What do you need, Ms. Mills? Do we need more detectives? Do we need more attorneys, more judges?

Because we can probably afford for those hundreds of millions of dollars, we can afford more of whatever we need to do this. If we need more investigators, I would rather cut the budget on that, add it if it is manpower and stop it. It hurts our veterans, but they are being stolen from anyway.

So what do we need? Is it people? Is it clerks?

Ms. MILLS. Yes. We are looking at all of our programs overall in terms of risk management because this has been a pervasive issue that no one has gone after these issues in a period of time, and as I testified the last time, it is not acceptable. We are not going to be the agency of fraud, waste, abuse and mismanagement.

So this requires a systematic approach across all of these programs that we are implementing. We have begun to collaborate with other agencies on a much more aggressive basis in order to make sure things like this eligibility that we need from the Vet-

erans Administration is available to us. That is a brand new collaboration.

Chairwoman VELÁZQUEZ. Would the gentleman yield?

Mr. ELLSWORTH. Yes, ma'am.

Chairwoman VELÁZQUEZ. Thank you.

In its FY 2010 budget, you request $32 million for the administration of contracting programs. How much of this money will go to the oversight and management of the service disabled veteran owned small business program.

Ms. MILLS. I would like to get back to you with an exact number, but I think it is an important and relevant question.

Chairwoman VELÁZQUEZ. Thank you for yielding.

Mr. ELLSWORTH. Absolutely. And I would just close by saying and thanks for that figure of 32 million. We here in Congress get asked to vote on pretty large numbers of budgets across the board, but the last thing, and I don't think it's just my history in law enforcement, that makes me think twice when people out there, good taxpayers paying good dollars, we are voting on this and then it is basically being stolen.

That does not set well with me and I know the rest of the pane either. So thank you, Mr. Kutz. Thank you, Ms. Mills. Do everything you can, and if you need anything, just come to us. I think everybody feels the same.

Thank you. I yield back.

Chairwoman VELÁZQUEZ. Mr. Bartlett.

Mr. BARTLETT. Thank you very much.

I just want to first express my pleasure at the different attitude at this hearing than at a similar hearing on HUBZONEs where it was look at those bad guys. That is, therefore a bad program, and let's kill the program.

We recognize that this is not a bad program. It is a very good program. There are some bad guys in it. Let's make sure that the bad guys do not stay in the program, and I am very pleased at that different attitude.

You know, you could have predicted when this program was set up that we were going to be here today with this hearing, and it is partly our fault. When I come to that part of the Lord's Prayer that says, "Lead us not into temptation," I cringe because what we did, we set up this program. We gave SBA nowhere near enough money to monitor this. They had in place no adequate program for monitoring. There is no certification, no review, no site review, and so forth.

And so you know, we are partly at fault. So I am very pleased at this hearing, Madam Chairman. We are doing the right thing, but you know, we could have predicted we were going to be here because, you know, people are human, and you know, when they see an opportunity to take advantage from them, they take advantage of it.

One other thing I want to point out, too, is that sometimes the government contractors are complicit in this because we lean on them for a goal. They have got to have so much percent go to this and that and the other thing, and they are very happy with these pass-throughs because they know that the service is going to be provided if it is a pass-through.

If they have a new company they have never heard of with a person that had no prior business experience, you know, how are they going to perform?

And the contracting officer is graded on the performance of people whom they give the contract. So it is a wink and a nod. They are not unhappy with this pass-through because they know if it is a pass-through to a reputable company that they have been doing business with before or is well known as a competent business, that the job is going to get done.

One of the things I have pleaded for is that we somehow give your contracting officers the goal of reaching out further, casting a wider net. You know, they have been giving contracts to Joe and he does a good job. They have got an RFP out and responses are in, and Sam looks like he has a better proposal. I do not know who Sam is. He may perform and he may not perform, but Joe always performs for me. He is not really good, but he is adequate, and I do not get scored down because of Joe's performance. I am going to give the contract to Joe.

I do not know how to reward our people for failure, but if you do not have a failure once as a while as a contracting officer, you are not reaching out far enough, are you? You are not casting a wide enough net.

Now, I do not know how to structure that. I do not know how to reward people, but I just think that they need to be told that we expect them to push the envelope. The creativity and entrepreneurship out there in the small business world is just incredible. I came from that world. I ended up with 20 patents, and I know that the environment in which you work is very essential to how creative you are going to be.

And so I am appreciative of this hearing. I am really appreciative of the different attitude today. This is a really good program. We have some bad actors in it. Let's make sure we do not have them in there in the future.

Thank you all very much for your contribution to this.

Chairwoman VELÁZQUEZ. Mr. Nye.

Mr. NYE. Thank you, Madam Chairwoman.

I have to admit I am, as I know all of us on the Committee are, shocked and dismayed to hear from you, Mr. Kutz, that you had 100 allegations that you chose to choose the ten from and you stopped at 100. You had received 100, but there were more coming in, but you stopped because that is all you could process at the time.

Clearly, the scope of the problem is large, and this is something that runs deep. It sheds a lot of doubt on our efforts to date. Obviously something is not going right, and we need to fix this problem, and what I want to make sure that we going head avoid is simply taking punitive action on these ten particular fraudulent businesses and then moving on and not fixing the system.

So we have got a big responsibility that we all share now to get this right going forward. Administrator Mills, I mentioned in my opening statement you just started this spring. This problem has obviously been endemic in the system before you came in, but you own the SBA portion of the response now. What I would like to make sure that I understand is what you see the SBA's role in in-

suring that short of a GAO study we have mechanisms in place to find out when companies are defrauding our veteran business owners earlier in the process rather than reacting at this stage in the game.

And I just want to make sure I kind of understand your view of the SBA's role vis-a-vis the contracting agencies who actually go out in the field and do the day-to-day contracting, and how do you see the SBA fitting in with those contracting officers in practicing the oversight to make sure that going forward we have ways to solve this problem?

Ms. MILLS. Thank you, Congressman Nye.

There are a number of pieces to this question that you just asked. First of all, overall on the specifics of this program, the first piece of it is to make sure we get the two nodes of the eligibility right. Pretty confident that we can get our node of it right, but we need to be able to have access to accurate data from the Veterans Administration. I think we have made good inroads in making a collaboration and having them push that up their priority scale.

Partnership is good, and we are going to make sure that stays top of mind.

Overall, we also work with all of the different agencies, and this is a bigger problem. We just heard Representative Bartlett also speak to some of this question about how do you make sure that the purchasing agents who are actually contracting are doing the right things, are aggressively, as he said, casting a wider net and, as you said, making sure that they let these contracts to people who they know are small businesses and are service disabled or meet various criteria?

We are highly focused on that issue, and the Recovery Act has allowed us really much greater force and impetus in our relationships with each of the different other agencies. That is one of the reasons why we are exceeding our goals.

So now that we have these very strong foundations with everyone from the VA to the Department of Defense that are working with us, we are able to do more training, set expectations, deliver consequences, work on going after and making examples of those who do not comply.

So there are a series of activities that will be required to make sure this entire contracting activity delivers full accountable, transparent and correct contracts to those who are eligible.

Mr. NYE. Okay. Well, I think what I am hearing is you see the SBA's role as being extremely proactive in terms of dealing with the federal agencies on their small business contract and to help insure that this kind of problem does not happen.

What I want to avoid, and I intend to hold additional hearings in my subcommittee on this particular topic about our service disabled veterans in business; what I want to avoid is the situation where we look back a year from now, recognize that we had a problem a year ago, and still find ourselves pointing fingers at the other saying, well, it was really kind of more their responsibility than ours and, you know, they are the one that did not do their job.

And I think clearly the SBA is in a position, I think, to take a leadership role here and help us solve this problem. So I am look-

ing forward to being at the position a year from now where we look back and can say we did it right and we really fixed this problem.

So I want to thank you for your comments.

Mr. Kutz, I just wanted to ask you. I noted in your report that contracting officers from some federal agencies seem to suggest and acknowledge that they really did not care much about the details of the execution of contracting to service disabled veteran owned companies, and that they were really just more concerned with making sure the contracting got done expediently.

I would like to know what your thoughts are how we can solve that problem. Is this a training issue with the contracting officers? How can we change that culture?

Because to my mind this problem can largely be solved with professional contracting officers that buy into the reason behind why we have these targets for contracting to our service disabled owned veterans. I think you have heard from all the members of this Committee how much we care about the mission and from our panelists today, but where the rubber meets the road out in the field, the contracting officers doing the day-to-day contracting, if they do not care about this program and if they do not care about the effect on employment for veterans, it is going to be very hard for us to get this right.

And so I would like to have your ideas about how we can fix that part of the problem.

Mr. KUTZ. Well, I think Mr. Bartlett made some very insightful comments on that. The contracting officers have kind of a perverse set of incentives out there. They are trying to reach these requirements. They want to get the work done with companies they already know. If a new company shows up that is a service disabled vet company, you know, they are not necessarily as comfortable with that.

So they have a lot of competing interests in this. So it is going to be a difficult issue to solve, and maybe we have to work on not just the goaling requirements, but they should also be held accountable for making sure you do not have fraud in this program.

Right now there seems to be no incentive for them to call it like that. There is much more incentive for them to say, "Hey, that is a service disabled veteran contract. I get a click. I get a score towards my performance measures," and if it is a big company doing the work, there seems to be no consequences in place.

It is a combination of they may not care, they may have the wrong set of incentives, and you know, they are really not involved with enforcement.

Chairwoman VELÁZQUEZ. Would the gentleman yield?

Mr. NYE. Yes, ma'am.

Chairwoman VELÁZQUEZ. I think that we have got a problem here where you find, you know, the contracting officer saying, "Well, that is not my responsibility. It is SBA's responsibility to call for accountability and oversight."

So whose responsibility is it to make sure that the program is accomplishing the goals in the way that was intended by the statute?

Mr. KUTZ. Well, as of now nobody, and that is the whole problem. So I know what the SBA is talking about here is looking forward. If you look back, the answer is nobody.

Chairwoman VELÁZQUEZ. And looking forward, the responsibility then lies—pardon?

Ms. MILLS. We take on that responsibility.

Chairwoman VELÁZQUEZ. Okay. Thank you for yielding.

Mr. NYE. Well, I appreciate your ideas. Again, it is disheartening to realize the depth of this problem, but again, thank you for doing the job of putting this report together to highlight the challenges we face and the fact that we have got to start today on solving this major problem.

We have service disabled veterans who have put on for the country this uniform and put their life on the line overseas for us, returned home, made the decision to again take a risk to get into starting a small business applying their skills, and playing by the rules, doing the best they can to compete honestly for contracts, getting put on the sidelines because there are those who decided to take advantage of the system, and we have not done enough to catch them and prevent them from being able to sideline our vets.

Clearly, I think we understand the scope of the problem. We know we have got marching orders going forward. I want to make sure that today marks the beginning of the end of this problem. I will be very disappointed if we look back a year from now and do not say that we achieved that goal.

Chairwoman VELÁZQUEZ. The time has expired.

Mr. NYE. So I thank you. I yield back.

Chairwoman VELÁZQUEZ. Mr. Coffman.

Mr. COFFMAN. Thank you, Madam Chairman.

I am obviously concerned as a combat veteran myself about what is going on in the SBA, but I want to speak to the Veterans Administration for a second and get Mr. Kutz's view on this because I have found such an extraordinary level of incompetence in terms of their own record keeping referencing eligibility that I have requested from the VA, after finding out that they had folks with the designation of prisoner of war that greatly exceeded the numbers by the Defense Department who had that status under the Veterans Administration from the Gulf War, from Vietnam right up to the present day.

They have yet to respond to me, and I think I gave them that question six months ago, and they do not know. So I think there is a lot of self-reporting that is not audited, that they do not corroborate the information with the Department of Defense. It is easy to create a DD-214, the discharge certificate.

So how would you evaluate that? The SBA has to rely on the VA in terms of that certification process, but could you speak to the VA certification process for eligibility?

Mr. KUTZ. A little bit. It is in its infancy, I would say. They have set it up. They are moving forward with it, and it is encouraging to have a good attitude, and they have some good ideas, but the reality is, and I will use Case Study No. 2, the company that passed through the work to the international firm from Denmark is a VA validated small business, service disabled veteran owned

company, and they are continuing to get service disabled contracts as we speak.

So they have gone through the validation process at VA and somehow VA said they were okay, and we are saying that they are not. So that is not a good sign, and so that means that there is probably a lot of work to do with their validation process here.

Mr. COFFMAN. It would seem to me that the Department of Defense has the records, and I know that there have been problems with the records in the past, you know, obviously before they have gone to electronic records, but at least now certainly for the younger generation of veterans where we have the means to communicate electronically between the Department of Defense and the Veterans Administration, they ought to be able to do that.

It hurts those of us that have served in this country in combat, particularly those who are disabled, when we are giving benefits to those who have not earned them, taking from those who have earned them.

But the Veterans Administration has got to do a better job in that process.

Madam Chairman, I yield back.

Chairwoman VELÁZQUEZ. Mr. Schrader.

Mr. SCHRADER. Thank you, Madam Chair.

I am looking for reassurance, Director. I would like to go back to the HUBZONE issues. You know, there are a lot of recommendations from the GAO on specific actions to take, and I guess I will feel better about the veterans program if I know that there have actually been changes in the front end controls, fraud detection is, you know, now a part of the culture of the agency, and that you are interested in doing suspensions, you know, decertifications, this sort of thing very proactively.

Could you tell me what actions you have done to improve things?

Ms. MILLS. Yes. In HUBZONES, we have now done about 1,000 site visits, 750 completed documentations through our process. Compared to a year ago the annual number was seven. So we are continuing to take those site visits and then use that understanding to reengineer our up front documentation process. So, number one, extensive site visits.

Number two, business process engineering of the documentation up front.

Number three, we actually have changed our certification process. We now ask for extensive documentation and are working through how to make sure we get the right documentation up front so that we can identify the particular issues that were causing the firms to be in there who should have not been in there.

Mr. SCHRADER. Were those announced or unannounced site visits?

Ms. MILLS. In the site visits, the way they do them is the unannounced portion is the verification of the location. So we do not tell them that we are coming. We go and make sure the location is there.

The second piece of the site visit—

Mr. SCHRADER. But they know that you are in the process of doing an investigation.

Ms. MILLS. No, they do not know anything. So totally unannounced to make sure that the HUBZONE office is in the HUBZONE. That is number one, unannounced.

Part 2, we give them between 24 and 48 hours to produce the paperwork that is required to make sure that 35 percent of their employee are employed within the HUB zone. So that is—

Mr. SCHRADER. What happens to them if they do not produce that work?

Ms. MILLS. They cannot be a HUBZONE person.

Mr. SCHRADER. Mr. Kutz, what is your view of what we just heard and how the program is working at this stage?

Mr. KUTZ. When we first looked at the HUBZONE program for this Committee, it was essentially a glorified self-certification program. Anybody and their brother could get in, and at this point, there is more due diligence done, and we have done some testing for you, and we will be reporting back to you on that whenever you would like us to.

But I would say there has been progress, but it is probably not where it needs to be.

Mr. SCHRADER. Back in February or whenever, out of the ten firms that were investigated, seven were still getting contracts. Have they been terminated now at this point, Director?

Ms. MILLS. I am sorry. Are we talking HUBZONES or are we talking—

Mr. SCHRADER. HUBZONES.

Ms. MILLS. Of this, yes. We have referred all of those dozens more.

Mr. SCHRADER. I am asking with the contracts, has their ability to get money from the federal government been terminated for all of the ten firms that were investigated by GAO last year?

Ms. MILLS. All of them have been referred to disbarment or prosecution, whatever relevant category, and many more.

Mr. SCHRADER. I just want the answer. I guess maybe I am misunderstanding you.

Ms. MILLS. Yes.

Mr. SCHRADER. I just want to know are they still getting federal money at this point.

Ms. MILLS. No, I do not believe so, and I am happy to report back on those for the record.

Mr. SCHRADER. Okay. Thank you.

So I am sorry. Just to follow up here, you know, this is a big deal. I mean, this is a big, big deal. We are trying to get businesses back on track, small businesses in particular. We would like the Small Business Administration to be part of that effort. These types of things make it very difficult for us to showcase the agency as one that can help solve problems when these types of issues are going on.

And I disagree with the fact they just need more money. I do not think that is the answer. If I had a dollar for every agency that told me in my legislative career they needed more money to solve the problem, I would be a wealthy man, but I think this is stuff that you should be doing already.

So to the point on it takes a while to do the debarments and complete decertification, shouldn't we be suspending these programs

when the GAO has already done the work? Why do we have to wait for the IG and your department to do the same work, if you will?

I understand for the debarment, yes, that is necessary, but for the suspension, why can't the agency just go off of that?

And then the last question is what other investigations has SBA done beyond what the GAO talked about or pointed out, those firms that the GAO identified? What other firms have you identified in the HUBZONE program since they did their work that are fraudulent and misusing taxpayer dollars?

Ms. MILLS. So we identified 1,000 first that we visited. We have cleared 750 of those, and of those, we have a number of them who did not comply, and we have excluded them from the program.

Mr. SCHRADER. Two hundred and fifty firms are excluded?

Ms. MILLS. Pardon? No. Seven hundred and fifty have passed and a number of them have not passed, and we can get you the pertinent information, but anybody who did not pass that inspection cannot participate in the HUBZONE programs.

Chairwoman VELÁZQUEZ. Time expired.

Mr. King.

Mr. KING. Thank you, Madam Chair. I appreciate you holding this hearing and having an opportunity to review the testimony that is before this Small Business Committee.

I would turn my first question to Administrator Mills. And as I look at the data that has been produced by the GAO, my question, and there have been many other questions asked that have to do with facts and functionality, but mine is in my business life, there were times when I thought working with people that were cheaper was a better business deal, and what I came to the conclusion was I have to work with honorable people, people that I can trust, people that have a culture within their company of having the integrity of knowing where the lines are and not crossing the lines.

And that is something that I am certainly confident I would pass on to the next generation, always to work with ethical people. So there is something within the culture of individuals and companies that tells them that somehow they can rationalize or justify a false presentation to gain an advantage from I am going to say the taxpayers, as is the case here; an advantage against disabled veterans, as we heard from Mr. Coffman.

And so I would ask you if you have any introspective comments you would like to make to this Committee about what you see within the underlying cultures in these companies that you have discovered were in violation of these standards.

Ms. MILLS. Well, thank you for your insights on this issue around procurement, and I have to agree that that is a critical value. We believe that contracting with small businesses provides great benefits not only for small businesses, but also for the taxpayer and the federal agency because these are some of the most valuable, innovative companies, and you get the attention of the CEO.

Mr. KING. But did you think about the cultures in the companies?

Ms. MILLS. Yes. So your point is, you k now, there are some bad actors in this. I do want to point out that there are many, many thousands of these companies, and there are many, many good ac-

tors in this, and I think your issue is well taken. These are things that I think we can address proactively in our procurement officer training, and I think we would like to think about your insights that you provided today.

Mr. KING. Well, thank you.

Let me make another point here, and that is in a different subject and a different Committee. There was a GAO investigation. It actually might have been IG, but it showed up that within one category there was 100 percent fraud in a single category.

And when I confronted the agency with that, they said, "Well, we are not analysts. We would have to be analysts to know what this is, what caused it and what to do about it."

Is that your position, that you are not analysts? Because I think that it is pretty simple. It is right up front, and I would think that the culture of the SBA should be if people are found to be in violation of these standards, there should be an immediate severance of the contract if you have the legal authority to do so.

So the second question is what about the culture of the SBA? What kind of people are looking over the shoulders of those who are, let's say, jumping the fences that are set in place by statute?

Ms. MILLS. The culture of the SBA is that we will not be the agency of fraud, waste, and abuse and mismanagement. We have an aggressive, high, new attitude towards this. It is explicit in one of our priorities.

Mr. KING. Thank you.

I would turn to Mr. Kutz and ask if you would just like to comment on the questions that I have asked Ms. Mills.

Mr. KUTZ. Yes, I would. On the first one your point being if these first will lie to us about whether they are service disabled vet firms are you going to have other issues, and the answer is yes. In fact, two of these ten cases we have come across in other fraudulent schemes. For example, one of them was doing trailer maintenance for Katrina in Louisiana and Mississippi, and we came across them potentially doing false billings for trailer inspections.

And so we referred those cases to another organization who raided their office in March of this year. Had they been suspended or debarred, they would not have continued to be allowed to get government contracts. So it is important when they lie to us and they cheat that we do something about it.

I agree with Representative Schrader that you can suspend someone without going through a lengthy three-year process of debarment. And back to the HUBZONE, none of the 29 companies we have identified that I am aware of have been debarred yet, none.

Now, there has been processes taking place, but it just goes to show you how long that process takes. With respect to SBA, I think SBA has good people. I think the history of SBA has been as an advocacy organization, not an enforcement organization, and therefore, you are not going to have the kind of people necessarily that are very good at this.

But I would argue that if you are going to be an advocate for small business you need to deal with the integrity of the program, and today's nearing is a good start.

Mr. KING. And to reinforce your point, and to briefly do so, I would like to think that in the operations that I run today and the

operations I have run in my business lifetime that I have people in place that would identify that at the most local level and send that up the chain with the strongest recommendation that there is the authority there to sever the contracts by the basis of the violation, and that would make it as far up the chain as it needed to deal with this problem, and they should be the ones exposing this, not having to go in with the GAO.

That is my point. I look at the culture, and that is the only thing that can fix it. We cannot write enough rules to fix it otherwise, but I thank both of the witnesses and I appreciate it, Madam Chair, and I yield back.

Chairwoman VELÁZQUEZ. Ms. Dahlkemper.

Ms. DAHLKEMPER. Thank you, Madam Chair, for bringing forward this very important hearing.

I appreciate both Mr. Kutz and Ms. Mills for being here today.

You know, first of all, of course, greed is an extremely motivating factor for many people in terms of finding holes in a program, and I want to ask, I guess, a little bit about the self-certification that we know was a problem in HUBZONE and it appears to be a problem here again. I guess I have a couple of questions.

First of all, how many companies are in this program? Do you know how many companies?

Mr. KUTZ. It is interesting. I do not think anybody knows for sure, but it is a self-certification program. There are at least 16,000 according to some evidence that we have seen, and, again, all you have to do to be in the program is to go to the central contract registry and say you are a service disabled veteran owned small business.

Some of the bogus companies that we have set up for this committee are also service disabled veteran owned small businesses. All you have to do is go in the system and say you are.

Ms. DAHLKEMPER. That is all you have to do.

Mr. KUTZ. That is all you have to do.

Ms. DAHLKEMPER. And then it just depends on somebody blowing the whistle on you.

Mr. KUTZ. A contracting officer taking a look there and saying, yes, that firm is in the system as being qualified. That is why you need this validation process, because right now the only place to go is a central contract registry, and anybody can go in there and say they are a service disabled vet.

Ms. DAHLKEMPER. Okay. So how would this program with the VA operate?

Ms. MILLS. Well, as I said earlier, there are two nodes of eligibility, and one of them we can provide, but the other one has to be provided by the VA, and as you heard earlier, they are working very hard on some systems issues that they have. They have agreed to up this in the priority chain. They know how important this is to us. This is a helpful moment to underline that importance, but they are being extremely cooperative in working through their systems issues.

Ms. DAHLKEMPER. And would all veterans businesses have to register before being eligible?

Mr. KUTZ. Right now only ones doing business with the Veterans Administration have to go through the process. That is why we had

suggested that, you know, either they work together to do it or you potentially legislate or do something else to encourage this to be more of a government-wide system. Because I think any program in place is going to have to have SBA and VA involved here. They are both going to have to be part of the solution.

Ms. DAHLKEMPER. Yes. I guess I am just wondering how many this would prevent from having the pass-throughs once we got the system in place. Do you see that that would really make a difference in these pass-throughs that we are seeing?

Mr. KUTZ. It depends on the processes. I think Representative Ellsworth said, you know, you have got human capital. That is one piece. Having good processes is another piece, and having good technology is a third piece. For example, if the address is a mailbox, there are ways to figure that out if you have got technology. So it is a combination of all three of those things that will need to be done. So I think the jury is still out on what VA has done so far, whether it is an effective process.

Ms. DAHLKEMPER. Of course, we need a solution to this, and I think that is what we all want here because it is a good program. It is a program that can certainly help all of our men and women who have served our country and come back and want to make a good living for themselves and their families.

I think I express what I think most of us or I am sure all of us feel here, is that whatever we can do here on this end to move this forward so that we do not have the same problems recurring over and over again, we want to see a change. I certainly would support suspension of certainly these ten companies that are listed here, probably the 100 or so that have come in.

My last question, I guess: is there a way once there is a whistle blower come in to sort of suspend while there is some initial investigation done to see if this company is involved in fraud and abuse?

Secretary Mills.

Ms. MILLS. Let me get back to you with exactly what the process is, but at this point we have and will refer anybody that we find that is not eligible. We will put them right in the process and go after that aggressively.

Ms. DAHLKEMPER. So if you get somebody reporting in as you did over 100 businesses, I mean, what is the process today?

Mr. KUTZ. Well, can I say I will tell you what we did? We set up our own hotline because GAO has a hotline for fraud government-wide. We set up our own Small Biz Gov hotline. So we have a separate hotline, and we reached out to veterans organizations, and they posted that hotline throughout the networks of veterans that they had.

So a lot of our allegations came from veterans. So we had veterans organizations working with us to feed those allegations into our hotline. They have separate hotline processes.

Ms. DAHLKEMPER. So once you get it in your hotline, what do you do with it?

Mr. KUTZ. We will investigate it if it is valid. Especially we had the open investigation for this Committee. So we actually proactively went after those cases because those cases took some time to investigate. We did field visits. We did unannounced site visits, interviewed individuals, the allagators, the actual compa-

nies, other contracting officers, to come up with these cases. So it does take some investigative work, but these were allegations specific about fraud.

An eligibility program might have more of a randomness to the unannounced site visits. It might have more of a risk-based approached.

Ms. DAHLKEMPER. Do you talk to teach other? I mean, when you get these allegations, do you refer back to the agency?

Mr. KUTZ. Yes, we will send them to the IG and we will share them with management also, and as I mentioned, we also shared these with the agencies that were doing the contracting. There is a ton of agencies that we are actually contracting with these. So I sent out—we sent out 15 or 20 letters.

Ms. DAHLKEMPER. And then what happens on your end when the SBA gets it?

Ms. MILLS. Well, these have gone to the IG, and we cooperate with the IG.

Ms. DAHLKEMPER. Okay. My time has expired. I yield back.

Chairwoman VELÁZQUEZ. Mr. Altmire.

Mr. ALTMIRE. No questions.

Chairwoman VELÁZQUEZ. Well, I do have some questions. Mr. Kutz, you noted that the VA is only now working to develop a database for the limited number of disabled veterans contracts that they award. Is it going to include whether or not the business is small?

Mr. KUTZ. I believe it would. I do not know for sure. It is in the early stages of the process, but it should, and again, it only relates to veterans contracting at this point. It would not relate to someone doing business with the Department of Defense, but for VA, I am assuming that the process goes beyond simply a service disabled vet.

Chairwoman VELÁZQUEZ. Okay. Given the fact that the VA contributed six out of the ten cases that you investigated, shouldn't we be considering other alternatives to address this problem?

Mr. KUTZ. Well, certainly you should be concerned, as I mentioned. Our Case Study Number 2 went through their validation process. It got a green light, and it was the one that passed through the business to the firm in Denmark, and so that is a firm that has issues. And how it got through the process I do not know, but that is something that does raise questions about how effective their process is.

Chairwoman VELÁZQUEZ. I am going to read some comments that were included as part of your response to GAO regarding the accountability and authority issue because you said that from now on you will be responsible if there is fraud committed or making sure that those who claim to be disabled veterans company are, in fact, disabled veterans small companies.

In your response to GAO on this investigation, you said, "It is ultimately up to the federal agency's contracting officers who have primary accountability for insuring only bona fide disabled veterans contracting firms perform these contracts." You go on to say, "SBA's responsibility lies in the formal bid protest process." And finally, "the SBA is only authorized to perform eligibility reviews in protest situations."

So in SBA's view, the contract officer then becomes responsible for halting contract disbursement and taking further action against the firm. Does that accurately reflect SBA's position?

Ms. MILLS. I think in answer to the question was who is responsible for making sure that three percent of all government contracts go to the service disabled veterans. That is our responsibility, and we have a series of procedures that you just described that create, you know, a pathway, some of which we have direct authority on, others of which we are just working across all agencies to make sure that we do better training, that we make it explicitly clear that if somebody violates this that they should no longer be in the program.

Chairwoman VELÁZQUEZ. Mr. Kutz, do you have any comment?

Mr. KUTZ. Yes. The letter to us said that the only responsibility they have is to report going toward the three percent, that they had no responsibility for fraud prevention, no real responsibility for monitoring, and no real responsibility for debarment. So the position you heard in her testimony is different than the letter we got.

Chairwoman VELÁZQUEZ. So where are you today?

Ms. MILLS. From statute, the responsibilities in the report are as described in the response. Overall we are responsible for making sure that three percent of these go to service disabled veterans, and in all of our contracting, I think I have made it pretty clear that we are not going to be the agency of fraud, waste, abuse and mismanagement. And that means that we have to go after it throughout the whole system, some places where we have full authority to do it and others where we are just going to try and take our best leadership role.

Chairwoman VELÁZQUEZ. Okay. Mr. Kutz, can you comment on their assessment of responsibility and authority?

Mr. KUTZ. Well, our view, our attorney's view was that they have the authority, but they have not exercised that authority. They have chosen not to exercise the authority looking backward. You have heard a different story of looking forward, I see.

Chairwoman VELÁZQUEZ. You know, we are here today reviewing all of the GAO report and you are saying you are going to do this and that, and that hopefully nothing will happen. But when there is a situation where the agency is saying that you do not have the authority and then it is the responsibility of the contracting officer of the agency that awards the contract and then the contracting officer is saying, "Well, that is not my responsibility. My responsibility is to make sure that we get the best bang for the buck and to procure the good, get the best price, and that they meet their time frame." So why do you claim that you do not have the authority?

Ms. MILLS. I think what Mr. Kutz said is that in the past the agency has said that they do not have the authority and that they do not want to undertake this. I think we have said, and I think Mr. Kutz just mentioned this, that looking forward we believe that this cannot be a process that is imbued with fraud, waste and abuse. We cannot be effective in helping small businesses, I think, as has been pointed out here, unless we take this on full face. And we are doing that.

Chairwoman VELÁZQUEZ. So I am a little bit confused based on the response and the letter that you sent to GAO. Aren't you, in terms of what SBA—

Mr. KUTZ. Well, I consider there have been two stories, but that is the importance of having congressional oversight hearings.

Chairwoman VELÁZQUEZ. Well, I just want to make sure that SBA admits and conducts their business in light of the authority that they have because this really contradicts the position that you are taking here today, and I just want to make sure that there is no room here for the contracting officer to say, "Well, it is not my responsibility," and for the agency to say, "Well, it is not ours. It is theirs, the contracting officer."

Ms. MILLS. I think we have been clear that we take this seriously. We are going to do everything in our power to make sure that we go after these issues. We are very appreciative of—

Chairwoman VELÁZQUEZ. And this is light of the authority provided to you under the statute?

Ms. MILLS. I think we are—

Chairwoman VELÁZQUEZ. I just want to make sure.

Well, thank you very much for your cooperation and your presence here today.

I ask unanimous consent that members will have five days to submit a statement and supporting materials for the record. Without objection, so ordered.

This hearing is now adjourned.

[Whereupon, at 11:29 a.m., the Committee meeting was adjourned.]

NYDIA M. VELAZQUEZ, NEW YORK
CHAIRWOMAN

SAM GRAVES, MISSOURI
RANKING MEMBER

Congress of the United States
U.S. House of Representatives
Committee on Small Business

2361 Rayburn House Office Building
Washington, DC 20515-6315

STATEMENT
of the
Honorable Nydia Velazquez, Chairwoman
House Committee on Small Business
"Oversight of the Small Business Administration and its Programs"
Thursday, November 19, 2009

In the 111th Congress, the House has made an unprecedented commitment to transparency. Under the Speaker's direction, the House has adopted Rule 11, which requires quarterly hearings on fraud, waste, abuse and mismanagement of programs under committee jurisdiction. I'm proud to say that the Small Business Committee has gone above and beyond that requirement. Since January, we've conducted no fewer than 16 oversight hearings. Today's discussion marks the third in a series we've held with GAO and SBA this year, and gives us an opportunity to gauge the state of the agency's programs.

These hearings are an important tool for measuring progress and gathering information. In the past, they have been enormously useful, not just for *spotting* SBA's problem areas, but also for *solving* them. In July, we met to examine Disaster Loans, a program that has been mired in controversy since Hurricane Katrina. That discussion generated a number of recommendations for improvement and, importantly, was the impetus behind the Small Business Disaster Readiness and Reform Act, introduced by Representative Parker Griffith.

SBA programs have always been a lifeline for struggling small firms. In light of the current downturn, they are more important than ever. These are initiatives that encourage greater competition in the marketplace and yield significant returns on the tax payer dollar. Even more importantly, they help create jobs. Small firms generate roughly 70% of new positions, and investments in these ventures are a down payment for job growth. That's why it's so important for SBA's programs to be running at full capacity. In past oversight hearings, however, GAO has shed light on some troubling areas in the agency's contracting portfolio.

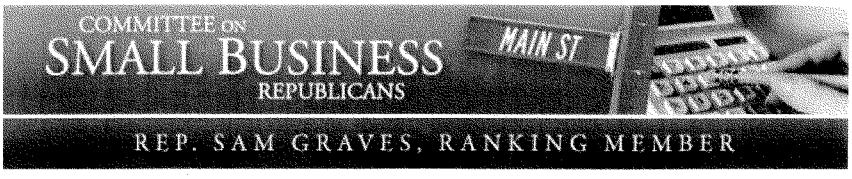
At our oversight hearing in May, GAO helped us identify considerable fraud within the HUBZONE program. In some cases, big businesses had gamed the system to win small business contracts. In other instances, firms in wealthy neighborhoods had posed as struggling ventures with HUBZONE addresses. In *all* cases, we knew just what we were looking at-- the fleecing of America's entrepreneurs. And, unfortunately, it seems to be happening to some of our most vulnerable businesses.

Fraud within the federal marketplace is never an acceptable thing. But it is particularly troubling when it comes at the expense of our veterans.
The disabled veterans contracting program was established as a means of empowering these men and women. With unemployment for severely disabled soldiers at 85%, it is particularly important today.

Entrepreneurship offers a kind of financial independence that other livelihoods cannot. We need to be sure it remains a viable option for our veterans--the men and women who have served our country so well. These brave Americans have *more* than earned their shot at entrepreneurship. And yet we now have reason to believe the disabled veterans program is being exploited by an unscrupulous few--dishonest businesses that have cheated our veterans out of countless opportunities.

This sort of abuse is more than a simple injustice. It is criminal, and it needs to be addressed immediately, not weeks or months down the road. The committee is not only going to look for ways to support the disabled veterans contracting program, but to hold the individuals accountable that have sought to game the system at the expanse our nation's veterans.

In times of economic turmoil, small firms have always relied on the SBA. Even amidst tremendous uncertainty, the agency has stood as a beacon of stability. It's critical that it continue to play that stabilizing role. Just as our economy is counting on small businesses to lead the recovery, small businesses are counting on SBA for strength and support. We cannot afford to let them down.



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Opening Statement for Hearing on
Oversight of the Small Business Administration and its Programs
Sam Graves
Ranking Member
Committee on Small Business
United States House of Representatives
Washington, DC
November 19, 2009

I would like to thank the Chairwoman for holding this important hearing today on Oversight of the Small Business Administration and its programs. I look forward to hearing the insight of all the witnesses about these programs, especially the Service-Disabled Veterans Small Business Contracting Program.

The Small Business Administration oversees a variety of programs, including procurement initiatives, designed to increase growth of small businesses. This Committee has responsibility to ensure that these programs operate to the benefit of small businesses, including the ones directed at specific groups, such as service-disabled veterans.

The Small Business Act requires that small businesses receive their fair share of opportunities to provide goods and services in the 434 billion dollar federal contracting marketplace. Congress then decided that within the segment of small businesses, those owned by service-disabled veterans deserve extra assistance for the sacrifices that they have made to defend the country. No one can deny that this assistance is deserved.

It is then troubling to find out that the program is subject to fraud. The investigation that will be discussed at this hearing reveals that some firms are not performing the

contracts; instead they are having the goods or services supplied by large businesses. In other cases, businesses are not owned by service-disabled veterans. The underlying problem, as it was with the HUBZone program, is the ability of a small business to self-certify eligibility for the program without any independent checks by the SBA.

By itself, the fraud would be problematic. However, it is more troubling that firms ineligible for the program then deny firms that are eligible for contracts. The firms denied contracts are those owned by individuals who made a significant sacrifice in defending our country. And that is simply unacceptable.

I look forward to hearing testimony of our witnesses today and learning about the steps they are taking to address the problems of fraud. If those actions do not prove successful in ensuring that service-disabled veteran small business owners benefit from the program, I will take aggressive legislative action to do so.

Again I thank the Chairwoman for holding this important hearing and look forward to suggestions on how to rid the program of fraud and abuse.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

Testimony of Karen G. Mills
Administrator
U.S. Small Business Administration

Before the
U.S. House of Representatives Committee on Small Business
Accountability Update
November 19, 2009

Chairwoman Velazquez, Ranking Member Graves and distinguished members of the Committee. As always, it's an honor to testify before this committee.

I want to thank the Committee for its efforts over the past several months. I am committed to investing in risk management and oversight. With your help, we are working to ensure that SBA programs provide maximum value to small business owners, while at the same time ensuring that taxpayer dollars are being spent wisely and transparently.

Considering the current economic realities, including the need for small business borrowers keep themselves in a viable position, our mission is particularly important. Given the exposure these guarantees represent to the taxpayer, a critical mission of my team is ensuring we have a strong credit risk management system, which includes strong lender oversight and portfolio monitoring.

The Recovery Act is another risk management focus for the agency. The temporary increased guarantee and lowered fees in our two flagship programs helped us achieve a turnaround in SBA lending.

The Agency has supported more than $14 billion in lending approvals to small businesses, with recent months at levels not seen since 2007.

Weekly loan dollar volumes have risen over 75% compared to the depths of the recession. Also, we now have more access points to capital, with more than 1,200 lenders now offering SBA loans who had not made a loan since October 2008.

I want to thank the Committee for the work you did on behalf of small businesses in the Recovery Act. Our feedback from entrepreneurs, small business owners and the lending community has been near-unanimous. They think that these enhancements have been critical to providing a lifeline for the small business community which is still having trouble finding credit and which is still trying to lead us out of recession.

Federal Recycling Program Printed on Recycled Paper

We will continue to monitor these and other SBA programs within the risk management framework we established for overseeing the rollout of the Recovery Act programs. Moreover, the senior members of the SBA leadership team are continuing to address outstanding and emerging areas of risk in a highly systematic way – especially focusing on recommendations brought to the agency by the Government Accountability Office (GAO) and the Office of the Inspector General.

To help us in these efforts, we are pleased to have a new Inspector General on board – Peggy Gustafson. Her work will help to ensure that the SBA is transparent and efficient in meeting the needs of America's small businesses.

Since the last hearing SBA regional training for our Women's Business Centers has been initiated in an effort to improve financial and program compliance. We expect to do financial reviews for more than half of the centers in this fiscal year. The first ten reviews are now completed. The results have shown these centers, after the training, are fully compliant.

Per the Chair's interest at our last hearing, I would like to give an update on the steps we have taken with disaster preparedness and assistance.

This week, the SBA sent three reports to Congress regarding the Disaster Loan program.

The updated Disaster Recovery Plan is intended to enhance the management structures by implementing a "surge" to meet the needs of disaster victims in the wake of catastrophic disaster.

The 2009 Annual Report on Disaster Assistance meets requirements outlined in the 2008 Farm Bill. It describes changes and improvements in areas such as the Disaster Credit Management System (DCMS) and the Disaster Information Gateway (DIG).

It also includes our plans to improve small business' access to disaster-related contracts and to roll out the commercial disaster lending pilot program.

This fall the SBA released and heavily promoted a preparedness guide to assist small businesses in planning for the H1N1 flu. The preparedness guide offers small business employers tools and information to help the plan for and respond flexibly to varying levels of severity of an H1N1 outbreak.

My vision is that the SBA will continue to operate in a way that allows each of our programs to meet the expectations of Congress, small businesses, and the American taxpayer.

I look forward to working with the distinguished members of this Committee to make that happen.

I welcome any questions, concerns and comments about any of our programs or efforts.

United States Government Accountability Office

GAO

Testimony

Before the Committee on Small Business, House of Representative

For Release on Delivery
Expected at 10:00 a.m. EST
Thursday, November 19, 2009

SERVICE-DISABLED VETERAN-OWNED SMALL BUSINESS PROGRAM

Case Studies Show Fraud and Abuse Allowed Ineligible Firms to Obtain Millions of Dollars in Contracts

Statement of Gregory D. Kutz, Managing Director
Forensic Audits and Special Investigations

GAO
Accountability * Integrity * Reliability

GAO-10-255T

Madam Chairwoman and Members of the Committee:

The Small Business Administration (SBA), which, along with federal procuring activities, administers the Service-Disabled Veteran-Owned Small Business (SDVOSB) program, reported in fiscal year 2008 that $6.5 billion[1] in federal contracts were awarded to firms who self-certified themselves as SDVOSBs. Government contracts to SDVOSBs accounted for only 1.5 percent of all government contract dollars paid in fiscal year 2008. Since the SDVOSB program began, the government has not met its annual mandated goal of 3 percent.[2] In addition to SBA's statutory authority over administration of the SDVOSB program, several other government agencies have separate authority over issues related to the SDVOSB program. The Veterans Benefits, Health Care, and Information Technology Act[3] requires the Department of Veterans Affairs (VA) to maintain a database of SDVOSBs and Veteran-Owned Small Businesses (VOSB) so contractor eligibility can be verified on VA SDVOSB and VOSB contracts. In addition, The Office of Federal Procurement Policy (OFPP), within the Office of Management and Budget, provides overall direction for governmentwide procurement policies, regulations, and procedures and to promote economy, efficiency, and effectiveness in the acquisition processes. The Office's primary focus is on the Federal Acquisition Regulation (FAR), the governmentwide regulation governing agency acquisitions of goods and services, including SDVOSB set-aside and sole-source contract actions.

My statement summarizes our report issued today to your committee.[4] This testimony discusses (1) whether cases of fraud and abuse exist within the SDVOSB program, and (2) whether the program has effective fraud-prevention controls in place.

[1]SBA calculates its SDVOSB total by including all dollars awarded to SDVOSBs, not just those received through set-aside or sole-source contracts.

[2]SBA's Small Business Procurement Scorecards report the annual percentage share of SDVOSB awards.

[3]Veterans Benefits, Heath Care, and Information Technology Act of 2006, Pub. L. No. 109-461, 120 Stat. 3433 (2006).

[4]GAO, Service-Disabled Veteran-Owned Small Business Program: Case Studies Show Fraud and Abuse Allowed Ineligible Firms to Obtain Millions of Dollars in Contracts, GAO-10-108 (Washington, D.C.: November 19, 2009).

To identify examples of firms that received SDVOSB contracts through fraudulent or abusive eligibility misrepresentations, we reviewed SDVOSB contract awards and protests filed with SBA since the program's inception in 2003. We also reviewed allegations of fraud and abuse sent to our fraud hotline, FraudNET. In addition, we posted inquiries on our Web page and on several veteran advocacy-group Web pages and newsletters seeking information on fraud or abuse of the SDVOSB program. We received over 100 allegations of fraud and abuse in the SDVOSB program. From these sources, we selected 10 cases for further investigation based on a variety of factors, including facts and evidence provided in protests and allegations, whether a firm received multiple SDVOSB contracts, and whether a firm received other non-SDVOSB contracts. To investigate these case studies, we interviewed firm owners and managers and reviewed relevant documentation, such as business filings and tax returns, to determine if SDVOSB eligibility requirements had been met. We also analyzed data from Federal Procurement Data System–Next Generation (FPDS-NG) for years 2003 through 2009[5] to identify SDVOSB contracts received by the firms since the program's inception. Furthermore, we reviewed certifications made by firms, such as certifications about a firm's size, SDVOSB status, and line of business, in the federal government's Online Representations and Certifications Application (ORCA).[6] To determine whether the program has effective fraud-prevention controls in place, we reviewed relevant laws and regulations governing the SDVOSB program. We also interviewed agency officials about their responsibility over the program and controls currently in place to prevent or detect fraud and abuse. Additional details on our scope and methodology can be found in our report that we issued today.[7]

We conducted our audit work and investigation from October 2008 through November 2009 in accordance with U.S. generally accepted

[5]The FPDS-NG is the central repository for capturing information on federal procurement actions. Dollar amounts reported by federal agencies to FPDS-NG represent the net amount of funds obligated and deobligated as a result of procurement actions. Because we did not obtain disbursement data, we were unable to identify the actual amounts received by firms.

[6]ORCA was established as part of the Business Partner Network, an element of the Integrated Acquisition Environment, which is implemented under the auspices of White House Office of Management and Budget, Office of Federal Procurement Policy, and the Chief Acquisition Officers Council. ORCA is the primary government repository for contractor-submitted representations and certifications required for the conduct of business with the government.

[7]GAO-10-108.

government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our objectives. We performed our investigative work in accordance with the standards prescribed by the Council of the Inspectors General on Integrity and Efficiency (CIGIE).

Ineligible Firms Obtain Millions of Dollars in SDVOSB Contracts

Fraud and abuse in the SDVOSB program allowed ineligible firms to improperly receive millions of dollars in set-aside and sole-source SDVOSB contracts, potentially denying legitimate service-disabled veterans and their firms the benefits of this program. We identified 10 case-study examples of firms that did not meet SDVOSB program eligibility requirements, which received approximately $100 million in SDVOSB contracts, and over $300 million in additional 8(a), HUBZone, and non-SDVOSB federal government contracts. SBA found four of the firms ineligible for the SDVOSB program through the agency's bid protest process.[8] Nevertheless, because there are no requirements to terminate contracts when firms are found ineligible, several contracting agencies allowed the ineligible firms to continue their work. In addition, we identified six other case-study firms that were not eligible for the SDVOSB program. The misrepresentations case-study firms made included a firm whose owner was not a service-disabled veteran, a serviced-disabled veteran who did not control the firm's day-to-day operations, a service-disabled veteran who was a full-time contract federal employee at MacDill Air Force Base, and firms that served as a "pass-through" for large and sometimes foreign-based corporations. In the case of a pass-through, a firm or joint venture lists a service-disabled veteran as the majority owner, but contrary to program requirements, all work is performed and managed by a non-service-disabled person or a separate firm.

Federal regulations set requirements for a small business to qualify as an SDVOSB. Specifically, SDVOSB eligibility regulations mandate that a firm must be a small business[9] and at least 51[10] percent–owned by one or more

[8] 15 U.S.C. §631 et seq. 13 CFR Parts 125 and 134.

[9] The criteria for a small business are defined in 13 CFR Part 121.

[10] For any publicly-owned business, not less than 51 percent of the stock must be owned by one or more service-disabled veterans.

service-disabled veterans[11] who control the management[12] and daily business operations of the firm. In addition, SDVOSB regulations also place restrictions on the amount of work that can be subcontracted. Specifically, regulations require the SDVOSB to incur a mandatory percentage of the cost of the contract performance that can range from 15 percent to 50 percent, depending on the type of goods or services. The Federal Acquisition Regulation (FAR) requires all prospective contractors to update ORCA to state whether their firm qualifies as an SDVOSB under specific North American Industry Classification System (NAICS) codes. Pursuant to 15 U.S.C. § 657 f(d), firms that knowingly making false statements or misrepresentations in certifying SDVOSB status are subject to penalties. Of the 10 cases we identify, all 10 of them represented to be SDVOSBs in the Central Contractor Registration (CCR).[13] Table 1 provides details on our 10 case-study firms that fraudulently or abusively misrepresented material facts related to their eligibility for the SDVOSB program. We have referred all 10 firms to appropriate agencies for further investigation and consideration for removal from the program.

[11]The term "veteran" means a person who served in the active military, naval, or air service, and who was discharged or released there from under conditions other than dishonorable. 38 U.S.C. 101(2). Service-disabled means, with respect to disability that such disability was incurred or aggravated in line of duty in the active military, naval, or air service.

[12]In the case of a veteran with permanent and severe disability, the spouse or permanent caregiver of such veteran may control the business.

[13]Central Contractor Registration (CCR) is the primary contractor registrant database for the U.S. Federal Government. CCR collects, validates, stores and disseminates data in support of agency acquisition missions.

Table 1: Case-Study Firm Details

Case	Industry business location	SDVOSB contracts[a] for years 2003-2009,[b] and awarding agency	Case details
1	Maintenance/repair North Las Vegas, Nev.	$7.5 million—Federal Emergency Management Agency (FEMA)	• Firm is ineligible because majority owner is not a service-disabled veteran. • Firm's ineligibility was determined by SBA during a bid protest in June of 2007. • After the SBA protest, in July of 2007 FEMA sent the firm a letter providing approximately 30-days to vacate SDVOSB contract awards. • Company continues to receive tens of millions in non-SDVOSB contracts. • SBA determined the firm was ineligible: however, the firm has not been suspended or debarred from receiving federal contracts.
2	Construction and janitorial services Chico, Calif.	$5 million—VA, U.S. Fish and Wildlife Service, Agricultural Research Service, U.S. Forest Service	• Firm is ineligible because it does not perform any work and subcontracts 100 percent of the work to non-SDVOSB firms. • Our investigation found firm employs three full-time workers and performs SDVOSB contract work with employees from a large international-based corporation that reported almost $12 billion in annual revenue in 2008. • Received over 20 SDVOSB contracts since 2008.
3	Construction/ maintenance/repair Carnegie, Pa.	$39.4 million—VA	• Firm is ineligible because a non-service-disabled veteran manages and controls the firm's daily operations. • Firm's ineligibility was determined by SBA during a bid protest. • Despite being determined ineligible, VA allowed the firm to continue multiple SDVOSB contracts, because there are no requirements for agencies to terminate contracts awarded to ineligible firms. • Non-SDVOSB construction company, located at the same address, manages and performs the SDVOSB contract work. • Service-disabled veteran owned and managed a restaurant in another city over 80 miles away when the contract was awarded. • SBA determined the firm was ineligible: however, the firm has not been suspended or debarred from receiving federal contracts.

Case	Industry business location	SDVOSB contracts[a] for years 2003-2009,[b] and awarding agency	Case details
4	Construction/ environmental/defense technology/maintenance San Diego, Calif.	$12.2 million—Environmental Protection Agency (EPA), FEMA	• Firm is ineligible because it is not a small business. • Our investigation determined that federal agencies have obligated approximately $171 million for payment to the firm during fiscal years 2003 to 2009 exceeding SBA size standards for average annual receipts. • Firm is also ineligible because it has formed at least five SDVOSB joint ventures violating SBA joint-venture rules. • Firm uses the employees from the large firm in the joint ventures to perform the SDVOSB contract work.
5	Septic tank and related services/facilities support services/rental and leasing services Austin, Tex.	$200,000—Army	• Firm and its SDVOSB joint ventures are ineligible for the program because a non-SDVOSB firm performs the work. • Firm and first joint venture were determined ineligible during an SBA bid protest. • After the SBA determination, the non-SDVOSB firm used another SDVOSB joint venture to continue to receive SDVOSB contracts. • Over $5 million in federal contracts has been obligated to the firm and its SDVOSB joint ventures since SBA ruled the firm and its first SDVOSB joint venture ineligible for the program. • Service-disabled veteran used to qualify for current contracts livesover 1,800 miles from contract-performance location. • SBA determined the firm was ineligible: however, the firm has not been suspended or debarred from receiving federal contracts.
6	Construction/ maintenance/repair/ medical and surgical equipment Burlington, N.J.	$8.1 million—VA	• Firm is ineligible because the service-disabled veteran owner is a full-time New Jersey state employee and does not manage the firm's day-to-day operations. • Our investigation also found that the firm's 49 percent owner, who is not a service-disabled veteran, owns five additional non-SDVOSB construction firms at the same address as the SDVOSB firm receiving contracts. • SBA bid protest initially determined the SDVOSB firm was ineligible because the service-disabled veteran did not own at least 51 percent of the firm. SBA later reversed its decision when the firm submitted revised paperwork.

Case	Industry business location	SDVOSB contracts[a] for years 2003-2009,[b] and awarding agency	Case details
7	Construction/roofing Boise, Idaho	$3.9 million—VA, Public Buildings Service, Army	• Firm is ineligible because a non-service-disabled veteran manages and controls the firm's daily operations. • Our investigation found that the service-disabled veteran is an employee of the firm performing the contract work. • Joint venture was established as a pass-through for a non-SDVOSB roofing firm. • SDVOSB joint venture and non-SDVOSB firm share employees and adjust payrolls to meet program percentage of work requirements. • Service-disabled veteran received only 26 percent of the joint venture's profits.
8	Construction/specialty trade contracting Leominster, Mass.	$13.8 million—VA, Coast Guard, Army, Public Buildings Service, National Park Service	• Firm is ineligible because a non-service-disabled veteran manages and controls the firm's daily operations. • During our investigation, firm executives admitted that the service-disabled veteran is not involved with SDVOSB construction contracts. • Service-disabled veteran is an IT specialist who currently works from home on nongovernment contracts. • All the company construction contracts are managed by the non-service-disabled partner of the firm. • The service-disabled veteran does not receive a salary from the company and received less in IRS 1099 distributions than the 10 percent minority owner of the firm. • Ten percent minority owner of the SDVOSB firm is also the president of another construction company located at the same address as the SDVOSB firm.

Case	Industry business location	SDVOSB contracts[a] for years 2003-2009,[b] and awarding agency	Case details
9	Construction/ maintenance/repair Luthersville, Ga.	$2.8 million—VA, US Coast Guard, USDA, and Army	• Firm is ineligible because a non-service-disabled veteran manages and controls the firm's day-to-day operations and because the SDVOSB firm is a pass-through for a non-SDVOSB firm. • Firm was determined ineligible through an SBA bid protest. • Through interviews and our review of documents submitted by the firm, we found that the SDVOSB firm only has four employees and the owner of a non-SDVOSB firm is responsible for day-to-day operations of SDVOSB contracts. • The SDVOSB firm submitted 10 joint-venture bids within a 5-month period, violating federal regulations. • After being found ineligible by SBA, SDVOSB firm continued to receive approximately $1.8 million in new SDVOSB contracts. • SBA determined the firm was ineligible: however, the firm has not been suspended or debarred from receiving federal contracts.
10	Furniture/merchant wholesaler Tampa, Fla.	$900,000—Air Force	• Firm is ineligible because it does not perform any work, and subcontracts 100 percent of the work to non-SDVOSB firms. • Our investigation found that the firm's service-disabled veteran owner works full-time as a DOD contract employee at MacDill Air Force Base—the same location as the contract award. • SDVOSB firm served as a pass-through to a company where the service-disabled veteran's wife works, who passed the work to a furniture manufacturer who designed, delivered, and installed the furniture. • Manufacturer performed planning, design, and installation of contracted goods. • This manufacturer is also on the GSA schedule and could have provided the contracted goods at a significantly lower price. • The firm's physical address is the owner's home and its mailing address is a mail-box rental store. • Contracting officials at MacDill Air Force Base were aware of the pass-through structure of the firm and approved the award knowing that the SDVOSB would not perform the required percentage of work.

Source: GAO analysis of FPDS, ORCA, CCR, contractor data, and interviews.

[a]Obligation amounts are rounded to the nearest $100,000.

[b]Year 2009 amounts are through July 2009.

SDVOSB Program Does Not Have Governmentwide Fraud-Prevention Controls

The 10 case studies discussed above show that significant control weaknesses in the SDVOSB program allow ineligible firms to receive millions in SDVOSB contracts. The lack of effective fraud-prevention controls by SBA and agencies awarding contracts allowed these ineligible firms to receive approximately $100 million of sole-source or set-aside SDVOSB contracts over the last several years. The SDVOSB program is essentially an eligibility-based program. However, neither the SBA, except when responding to a protest, nor contracting officials are currently verifying the eligibility of firms claiming to be SDVOSBs. For example, currently the SBA and contracting agencies do not have a process in place to access the VA service-disabled veteran's database listing individuals that are valid service-disabled veterans. In addition, contracting officers are not required to validate that a firm's owner is a service-disabled veteran prior to award. Unlike other small business contracting programs, such as the HUBZone and 8(a) programs, there also are no documentation submissions to substantiate eligibility for the program or application process associated with the SDVOSB program. This lack of controls substantially increases the risk for fraud and abuse in the SDVOSB program.

The only process in place to detect fraud in the SDVOSB program involves a formal bid protest process at the SBA, whereby interested parties to a contract award can protest if they feel a firm misrepresented its small business size or SDVOSB eligibility in its bid submission. However, as shown by our case studies, this self-policing process does not prevent ineligible firms from receiving SDVOSB contracts. For example, bid-protest decisions do not always result in the termination of contracts with ineligible firms, even when termination costs would be minimal in cases where contract work had not begun. As some of our case studies show, even when firms are found ineligible to receive a contract, they can still retain it because current regulations do not require that the contracting agency terminate the contract. In addition, none of the firms found ineligible by the SBA through SDVOSB-status protests were suspended or debarred from receiving SDVOSB and other government contracts. When asked about its bid protest process, SBA officials stated that the bid protest process focuses on determining the eligibility of a firm for a specific contract and providing details on why a firm was found to be eligible or ineligible. SBA officials also stated that bid protest decisions do not include recommendations for suspension or debarment.

Recently, in response to the Veterans Benefits, Health Care, and Information Technology Act,[14] VA has taken steps to develop a validation program for contracts it awards to SDVOSBs and Veteran-Owned Small Businesses (VOSB). While not yet fully implemented,[15] this validation program includes steps to verify a firm's eligibility for the program including validating an owner's SDV status and his/her control of day-to-day operations. The VA program also includes plans for site visits to firms seeking VA certification as an SDVOSB or VOSB. Requiring submission of documents to demonstrate ownership and control of an SDVOSB has some value as a deterrent—ownership documents could have prevented instances demonstrated in our case studies where the service-disabled veteran was receiving less than 51 percent of the profits. The most effective preventive controls involve the verification of information, such as verifying service-disabled status with the VA's database and service-disabled veteran participation in the business through an unannounced site visit. Verification of service-disabled veteran status by using the VA's database could have prevented the most egregious example of fraud where the owner was not even a service-disabled veteran. Although VA's proposed system was not intended for governmentwide use, once the certification system is in place, all SDVOSBs wishing to do business with VA will have to be certified.

Matter for Congressional Consideration

Our report documented 10 cases where the governmentwide self-certification system over the SDVOSB program allowed ineligible firms to receive millions of dollars in federal contracts. However, through the Veterans Benefits, Health Care, and Information Technology Act of 2006, Congress required VA to maintain a database of SDVOSBs, determine whether SDVOSBs are indeed owned and controlled by service-disabled veterans, and required VA set-aside and sole-source awards be made only to firms that have had their eligibility verified. Currently, the only efforts to put fraud prevention controls in place are at VA through their VetBiz program, which applies only to VA contracts. Given that outside of VA there is no verification program in place for SDVOSB contracting, we suggested in our report that Congress should consider providing VA with the authority and resources necessary to expand its SDVOSB eligibility

[14]Veterans Benefits, Heath Care, and Information Act of 2006, Pub. L. No. 109-461, 120 Stat. 3433 (2006).

[15]See GAO, *Department of Veterans Affairs Contracting with Veteran-Owned Small Businesses*, GAO-09-391R (Washington, D.C.: Mar. 19, 2009).

verification process to all contractors seeking to bid on SDVOSB contracts governmentwide.

GAO Recommendations

To address the concerns identified, we made recommendations in our report that the Administrator of the Small Business Administration (SBA) and the Secretary of the Veterans Affairs (VA) coordinate with the Office of Federal Procurement Policy (OFPP) to explore the feasibility of: (1) expanding the use of the VA VetBiz "verified" database governmentwide for purposes of validating all SDVOSB eligible firms for contracting, and (2) requiring that all contractors who knowingly misrepresent their status as an SDVOSB be debarred for a reasonable period of time. In addition, we recommended the Administrator of SBA refer all SDVOSB firms that submit misrepresentations of their status to SBA's Office of Inspector General for review and further investigation.

In response to our recommendations, VA generally agreed with our two recommendations. In its response VA expressed that specific authority would be required for other agencies to be able to rely on the department's VetBiz database and exclude firms from acquisitions if not "verified" in this database. SBA's response, provided by the Associate Administrator for Government contracting and Business Development, generally agreed with our recommendations; however, in its general observations and specific responses to our recommendations, SBA stated that they have limited responsibilities over the SDVOSB program and questioned the efficacy of one of our recommendations. Specifically, SBA stated that agency contracting officers bear the primary responsibility for ensuring only eligible SDVOSB firms perform SDVOSB set aside and sole source contracts. SBA also stated it is only authorized to perform eligibility reviews in a bid protest situation, and contracting officers, not SBA, are responsible for taking appropriate action after a bid protest decision is made. The Associate Administrator maintained that SBA was under no legal obligation to create a protest process for the SDVOSB program, and that its only statutory obligation is to report on other agencies' success in meeting SDVOSB contracting goals. In addition, SBA expressed that it was not obligated to institute any type of fraud prevention controls within the SDVOSB program.

Madam Chairwoman and Members of the Committee, this concludes my statement. I would be pleased to answer any questions that you or other Members of the Committee may have at this time.

Contacts and Acknowledgements

For further information about this testimony, please contact Gregory D. Kutz at (202) 512-6722 or kutzg@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony.

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GAO

Report to the Chairwoman, Committee on Small Business, House of Representatives

October 2009

SERVICE-DISABLED VETERAN-OWNED SMALL BUSINESS PROGRAM

Case Studies Show Fraud and Abuse Allowed Ineligible Firms to Obtain Millions of Dollars in Contracts

GAO
Accountability * Integrity * Reliability

GAO-10-108

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Accountability·Integrity·Reliability

Highlights

Highlights of GAO-10-108, a report to the Chairwoman, Committee on Small Business, House of Representatives

Why GAO Did This Study

The Service-Disabled Veteran-Owned Small Business (SDVOSB) program is intended to provide federal contracting opportunities to qualified firms. In fiscal year 2007, the Small Business Administration (SBA) reported $4 billion in governmentwide sole source and set aside SDVOSB contract awards. Given the amount of federal contract dollars being awarded to SDVOSB firms, GAO was asked to determine (1) whether cases of fraud and abuse exist within the SDVOSB program, and (2) whether the program has effective fraud-prevention controls in place.

To identify whether cases exist, GAO reviewed SDVOSB contract awards and protests since 2003, and complaints sent to our fraud hotline. GAO defined a case as one or more affiliated firms who were awarded one or more SDVOSB contracts. To assess fraud-prevention controls, GAO reviewed laws and regulations and conducted interviews with SBA and Department of Veterans Affairs (VA) officials. GAO did not attempt to project the extent of fraud and abuse in the program.

What GAO Recommends

Congress should consider providing VA authority and resources to expand its SDVOSB eligibility process governmentwide. GAO also recommends that SBA and VA explore the feasibility of governmentwide use of the VA VetBiz verified database for SDVSOB contractors. SBA and VA generally agreed with the recommendations.

View GAO-10-108 or key components. For more information, contact Gregory Kutz at (202) 512-6722 or kutzg@gao.gov.

October 2009

SERVICE-DISABLED VETERAN-OWNED SMALL BUSINESS PROGRAM

Case Studies Show Fraud and Abuse Allowed Ineligible Firms to Obtain Millions of Dollars in Contracts

What GAO Found

GAO found that the SDVOSB program is vulnerable to fraud and abuse, which could result in legitimate service-disabled veterans' firms losing contracts to ineligible firms. The 10 case-study firms identified in this report received approximately $100 million from SDVOSB contracts through fraud or abuse of the program, or both. For example, contracts for Hurricane Katrina trailer maintenance were awarded to a firm whose owner was not a service-disabled veteran. GAO also found SDVOSB companies used as a pass-through for large, sometimes multinational corporations. In another case a full-time federal contract employee at MacDill Air Force Base set up a SDVOSB company that passed a $900,000 furniture contract on to a company where his wife worked, which passed the work to a furniture manufacturer that actually delivered and installed the furniture. The table below provides details for 3 of the 10 cases.

Details of 3 Ineligible SDVOSB Cases

Industry	Award—agency	Notes
Maintenance and repair	$7.5 million—Federal Emergency Management Agency (FEMA)	Firm is not eligible because majority owner is not a service-disabled veteran. Firm's ineligibility was determined by SBA during a bid protest. Company continues to receive tens of millions in non-SDVOSB contracts.
Construction and janitorial services	$5 million—VA, U.S. Fish and Wildlife Service, Agricultural Research Service, U.S. Forest Service	Firm is ineligible because it does not perform any work and subcontracts 100 percent of the work to non-SDVOSB firms. Our investigation found the SDVOSB firm utilizes employees from a large non-SDVOSB foreign-based corporation, which reported almost $12 billion in annual revenue in 2008, to perform contracts.
Septic tank and related services	$200,000—Army	Firm and its SDVOSB joint ventures are ineligible for the program because a non-SDVOSB firm performs all contract work. After being found ineligible for the program by SBA, the firm used another SDVOSB joint venture to continue to receive SDVOSB contracts. Service-disabled veteran used to qualify for current contracts lives over 1,800 miles from contract performance location.

Source: GAO.

GAO found that the government does not have effective fraud-prevention controls in place for the SDVOSB program. Specifically, SBA and agencies awarding SDVOSB contracts do not have processes in place to validate a firm's eligibility for the program prior to bid submission. SBA and contracting agencies also currently do not have a database of individuals that are service-disabled veterans, a key eligibility requirement for the program. According to VA, it is developing a database, called VetBiz, of validated SDVOSBs, but currently it is only used for contracting by the VA. SBA's bid-protest process is the only governmentwide control over the SDVOSB program. However, although ineligible firms have been identified through bid protests, firms found ineligible do not face real consequences, can be allowed to complete the contracts received, and are not suspended or debarred.

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Abbreviations

CCR	Central Contractor Registration
EPA	Environmental Protection Agency
FAR	Federal Acquisition Regulation
FEMA	Federal Emergency Management Agency
FPDS-NG	Federal Procurement Data System-Next Generation
HUBZone	Historically Underutilized Business Zone
NAICS	North American Industry Classification System
OFPP	Office of Federal Procurement Policy
ORCA	Online Representations and Certifications Application
SBA	Small Business Administration
SDO	Suspension and Debarment Official
SDVOSB	Service-Disabled Veteran-Owned Small Business
USDA	United States Department of Agriculture
VOSB	Veteran-Owned Small Business
VA	Department of Veterans Affairs

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United States Government Accountability Office
Washington, DC 20548

October 23, 2009

The Honorable Nydia M. Velazquez
Chairwoman
Committee on Small Business
House of Representatives

Dear Madam Chairwoman:

The federal government's long-standing policy has been to use its buying power—the billions of dollars it spends through contracting each year—to maximize procurement opportunities for small businesses. The Service-Disabled Veteran-Owned Small Business (SDVOSB) procurement program is an extension of this policy. It also is intended to honor the extraordinary service rendered to the United States by veterans with disabilities incurred or aggravated in the line of duty during active service with the armed forces. The Veterans Benefits Act of 2003,[1] which established the program, permits contracting officers to award set-aside and sole-source contracts to any small business concern owned and controlled by one or more service-disabled veterans. Executive Order 13360 also requires federal procurement officials and prime contractors to provide opportunities for these firms to increase their federal contracting and subcontracting. The statutorily-mandated prime and sub contracting goal[2] for SDVOSB participation is not less than 3 percent of all federal contract dollars.

In order to be eligible for a set-aside or sole-source SDVOSB contract, a firm must meet certain criteria. It must be majority-owned[3] by one or more service-disabled veterans who manage and control[4] daily business operations. The term "veteran" means a person who served in the active military, naval, or air service, and who was discharged or released under conditions other than dishonorable. Service-disabled means that the disability occurred or became aggravated during the line of duty in the

[1]Pub. L. No. 108-183, § 308, 117 Stat, 2651, 2662 (2003).

[2]Veteran Entrepreneurship Act of 1999, Pub. L. No. 106-50, § 502, 113 Stat. 233, 247 (1999).

[3]If the business is publicly owned, at least 51 percent of the stock must be held by one or more service-disabled veterans.

[4]In the case of a veteran with permanent and severe disability, the spouse or permanent caregiver of such veteran may control the business.

active military, naval, or air service.[5] A firm also must qualify as a small business under the North American Industry Classification System (NAICS)[6] industry-size standards. Firm officials are allowed to self-certify themselves as being an SDVOSB by attesting that they meet the criteria.

The Small Business Administration (SBA), which, along with federal procuring activities, administers the SDVOSB program and tracks the government's progress towards meeting its 3 percent goal,[7] reported in fiscal year 2007 that $4 billion[8] in federal contracts were awarded to firms who self-certified themselves as SDVOSBs. Government contracts to SDVOSBs accounted for only 1 percent of all government contract dollars paid in fiscal year 2007. Since the SDVOSB program began, the government has not met its annual mandated goal. In addition to SBA's statutory authority over administration of the SDVOSB program, several other government agencies have separate authority over issues related to the SDVOSB program. The Veterans Benefits, Health Care, and Information Technology Act[9] requires the Department of Veterans Affairs (VA) to maintain a database of SDVOSBs and Veteran-Owned Small Businesses (VOSB) so contractor eligibility can be verified, and requires VA to determine the eligibility of firms bidding on VA SDVOSB and VOSB contracts. In addition, The Office of Federal Procurement Policy (OFPP), within the Office of Management and Budget, provides overall direction for governmentwide procurement policies, regulations, and procedures and to promote economy, efficiency, and effectiveness in the acquisition processes. The Office's primary focus is on the Federal Acquisition Regulation (FAR), the governmentwide regulation governing agency acquisitions of goods and services, including SDVOSB set-aside and sole-source contract actions.

[5]38 U.S.C. § 101(2).

[6]The North American Industry Classification System (NAICS) is the standard used by Federal statistical agencies in classifying business establishments for the purpose of collecting, analyzing, and publishing statistical data related to the U.S. business economy.

[7]SBA's Small Business Procurement Scorecards report the annual percentage share of SDVOSB awards.

[8]SBA calculates its SDVOSB total by including all dollars awarded to SDVOSBs, not just those received through set-aside or sole-source contracts.

[9]Veterans Benefits, Heath Care, and Information Act of 2006, Pub. L. No. 109-461, 120 Stat. 3433 (2006).

Given the billions of dollars of federal contracts being awarded to SDVOSB firms and the committee's concern that ineligible firms are receiving SDVOSB set-aside and sole-source contracts instead of legitimate SDVOSB firms, you requested that we perform an investigation to determine (1) whether cases of fraud and abuse exist within the SDVOSB program, and (2) whether the program has effective fraud-prevention controls in place.

To identify examples of firms that received SDVOSB contracts through fraudulent or abusive eligibility misrepresentations, we reviewed SDVOSB contract awards and protests filed with SBA since the programs inception in 2003. We also reviewed allegations of fraud and abuse sent to our fraud hotline, FraudNET. In addition, we posted inquiries on our Web page and on several veteran advocacy-group Web pages and newsletters seeking information on fraud or abuse of the SDVOSB program. We received over 100 allegations of fraud and abuse in the SDVOSB program. From these sources, we selected 10 cases for further investigation based on a variety of factors, including facts and evidence provided in protests and allegations, whether a firm received multiple SDVOSB contracts, and whether a firm received other non-SDVOSB contracts. For the purposes of our investigation, we defined a case as one or more affiliated firms or joint ventures that obtained an SDVOSB contract. These cases include multiple firms owned by an individual or multiple firms affiliated through joint ventures and other types of partner agreements. To investigate these case studies, we interviewed firm owners and managers and reviewed relevant documentation, such as business filings and tax returns, to determine if SDVOSB eligibility requirements had been met. We also analyzed data from Federal Procurement Data System–Next Generation (FPDS-NG) for years 2003 through 2009[10] to identify SDVOSB contracts received by the firms since the program's inception. Furthermore, we reviewed certifications made by firms, such as certifications about a firm's size, SDVOSB status, and line of business, in the federal government's Online

[10]The FPDS-NG is the central repository for capturing information on federal procurement actions. Dollar amounts reported by federal agencies to FPDS-NG represent the net amount of funds obligated and deobligated as a result of procurement actions. Because we did not obtain disbursement data, we were unable to identify the actual amounts received by firms.

Representations and Certifications Application (ORCA).[11] To determine whether the program has effective fraud-prevention controls in place, we reviewed relevant laws and regulations governing the SDVOSB program. We also interviewed agency officials about their responsibility over the program and controls currently in place to prevent or detect fraud and abuse.

Our work was not designed to identify all firms that misrepresent themselves as SDVOSBs or commit fraudulent or abusive activity in the SDVOSB program. Our work also did not attempt to identify fraud and abuse in SDVOSB subcontracts. Our work focused on determining whether selected firms met program eligibility requirements. In addition, our 10 case study examples cannot be projected to the overall population of SDVOSB firms.

We conducted our audit work and investigation from October 2008 through July 2009 in accordance with U.S. generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our objectives. We performed our investigative work in accordance with the standards prescribed by the Council of the Inspectors General on Integrity and Efficiency (CIGIE). Additional details on our scope and methodology are included in appendix I.

Ineligible Firms Obtain Millions of Dollars in SDVOSB Contracts

Fraud and abuse in the SDVOSB program allowed ineligible firms to improperly receive millions of dollars in set-aside and sole-source SDVOSB contracts, potentially denying legitimate service-disabled veterans and their firms the benefits of this program. We identified 10 case-study examples of firms that did not meet SDVOSB program eligibility requirements, received approximately $100 million in SDVOSB contracts, and over $300 million in additional dollars of 8(a), HUBZone,

[11]ORCA was established as part of the Business Partner Network, an element of the Integrated Acquisition Environment, which is implemented under the auspices of White House Office of Management and Budget, Office of Federal Procurement Policy, and the Chief Acquisition Officers Council. ORCA is the primary government repository for contractor-submitted representations and certifications required for the conduct of business with the government.

and non-SDVOSB federal government contracts. SBA found four of the firms ineligible for the SDVOSB program through the agency's bid protest process.[12] Nevertheless, because there are no requirements to terminate contracts when firms are found ineligible, several contracting agencies allowed the ineligible firms to continue their work. In addition, we identified six other case-study firms that were not eligible for the SDVOSB program. The misrepresentations case-study firms made included a firm whose owner was not a service-disabled veteran, a serviced-disabled veteran who did not control the firm's day-to-day operations, a service-disabled veteran who was a full-time contract federal employee at MacDill Air Force Base, and firms that served as a "pass-through" for large and sometimes foreign-based corporations. In the case of a pass-through, a firm or joint venture lists a service-disabled veteran as the majority owner, but contrary to program requirements, all work is performed and managed by a non-service-disabled person or a separate firm.

Federal regulations set requirements for a small business to qualify as an SDVOSB. As stated above, SDVOSB eligibility regulations mandate that a firm must be a small business[13] and at least 51[14] percent–owned by one or more service-disabled veterans[15] who control the management[16] and daily business operations of the firm. In addition, SDVOSB regulations also place restrictions on the amount of work that can be subcontracted. Specifically, regulations require the SDVOSB to incur a mandatory percentage of the cost of the contract performance that can range from 15 percent to 50 percent, depending on the type of goods or services. The Federal Acquisition Regulation (FAR) requires all prospective contractors to update ORCA to state whether their firm qualifies as an SDVOSB under specific NAICS codes. Pursuant to 15 U.S.C. § 657 f(d), firms that knowingly making false statements or misrepresentations in certifying SDVOSB status are subject to penalties. Of the 10 cases we identify in this

[12]15 U.S.C. §631 et seq. 13 CFR Parts 125 and 134.

[13]The criteria for a small business are defined in 13 CFR Part 121.

[14]For any publicly owned business, not less than 51 percent of the stock must be owned by one or more service-disabled veterans.

[15]The term "veteran" means a person who served in the active military, naval, or air service, and who was discharged or released there from under conditions other than dishonorable. 38 U.S.C. 101(2). Service-disabled means, with respect to disability that such disability was incurred or aggravated in line of duty in the active military, naval, or air service.

[16]In the case of a veteran with permanent and severe disability, the spouse or permanent caregiver of such veteran may control the business.

report, all 10 of them represented to be SDVOSBs in the Central Contractor Registration (CCR)[17]. Table 1 provides details on our 10 case-study firms that fraudulently or abusively misrepresented material facts related to their eligibility for the SDVOSB program. We plan to refer all 10 firms to appropriate agencies for further investigation and consideration for removal from the program.

Table 1: Case-Study Firm Details

Case	Industry business location	SDVOSB contracts[a] for years 2003-2009,[b] and awarding agency	Case details
1	Maintenance/repair. North Las Vegas, Nev.	$7.5 million—Federal Emergency Management Agencey (FEMA)	• Firm is ineligible because majority owner is not a service-disabled veteran. • Firm's ineligibility was determined by SBA during a bid protest in June of 2007. • After the SBA protest, in July of 2007 FEMA sent the firm a letter providing approximately 30-days to vacate SDVOSB contract awards. • Company continues to receive tens of millions in non-SDVOSB contracts. • SBA determined the firm was ineligible: however, the firm has not been suspended or debarred from receiving federal contracts.
2	Construction and janitorial services Chico, Calif.	$5 million—VA, U.S. Fish and Wildlife Service, Agricultural Research Service, U.S. Forest Service	• Firm is ineligible because it does not perform any work and subcontracts 100 percent of the work to non-SDVOSB firms. • Our investigation found firm employs three full-time workers and performs SDVOSB contract work with employees from a large international-based corporation that reported almost $12 billion in annual revenue in 2008. • Received over 20 SDVOSB contracts since 2008.

[17]Central Contractor Registration (CCR) is the primary contractor registrant database for the U.S. Federal Government. CCR collects, validates, stores and disseminates data in support of agency acquisition missions.

Case	Industry business location	SDVOSB contracts[a] for years 2003-2009,[b] and awarding agency	Case details
3	Construction/ maintenance/repair Carnegie, Pa.	$39.4 million—VA	• Firm is ineligible because a non-service-disabled veteran manages and controls the firm's daily operations. • Firm's ineligibility was determined by SBA during a bid protest. • Despite being determined ineligible, VA allowed the firm to continue multiple SDVOSB contracts, because there are no requirements for agencies to terminate contracts awarded to ineligible firms. • Non-SDVOSB construction company, located at the same address, manages and performs the SDVOSB contract work. • Service-disabled veteran owned and managed a restaurant in another city over 80 miles away when the contract was awarded. • SBA determined the firm was ineligible: however, the firm has not been suspended or debarred from receiving federal contracts.
4	Construction/ environmental/ defense technology/ maintenance San Diego, Calif.	$12.2 million—Environmental Protection Agency (EPA), FEMA	• Firm is ineligible because it is not a small business. • Our investigation determined that federal agencies have obligated approximately $171 million for payment to the firm during fiscal years 2003 to 2009 exceeding SBA size standards for average annual receipts. • Firm is also ineligible because it has formed at least five SDVOSB joint ventures violating SBA joint-venture rules. • Firm uses the employees from the large firm in the joint ventures to perform the SDVOSB contract work.
5	Septic tank and related services/ facilities support services/rental and leasing services Austin, Tex.	$200,000—Army	• Firm and its SDVOSB joint ventures are ineligible for the program because a non-SDVOSB firm performs the work. • Firm and first joint venture were determined ineligible during an SBA bid protest. • After the SBA determination, the non-SDVOSB firm used another SDVOSB joint venture to continue to receive SDVOSB contracts. • Over $5 million in federal contracts has been obligated to the firm and its SDVOSB joint ventures since SBA ruled the firm and its first SDVOSB joint venture ineligible for the program. • Service-disabled veteran used to qualify for current contracts lives over 1,800 miles from contract-performance location. • SBA determined the firm was ineligible: however, the firm has not been suspended or debarred from receiving federal contracts.
6	Construction/ maintenance/repair/ medical and surgical equipment Burlington, N.J.	$8.1 million—VA	• Firm is ineligible because the service-disabled veteran owner is a full-time New Jersey state employee and does not manage the firm's day-to-day operations. • Our investigation also found that the firm's 49 percent owner, who is not a service-disabled veteran, owns five additional non-SDVOSB construction firms at the same address as the SDVOSB firm receiving contracts. • SBA bid protest initially determined the SDVOSB firm was ineligible because the service-disabled veteran did not own at least 51 percent of the firm. SBA later reversed its decision when the firm submitted revised paperwork.

Case	Industry business location	SDVOSB contracts[a] for years 2003-2009,[b] and awarding agency	Case details
7	Construction/ roofing Boise, Idaho	$3.9 million—VA, Public Buildings Service, Army	• Firm is ineligible because a non-service-disabled veteran manages and controls the firm's daily operations. • Our investigation found that the service-disabled veteran is an employee of the firm performing the contract work. • Joint venture was established as a pass-through for a non-SDVOSB roofing firm. • SDVOSB joint venture and non-SDVOSB firm share employees and adjust payrolls to meet program percentage of work requirements. • Service-disabled veteran received only 26 percent of the joint venture's profits.
8	Construction/ specialty trade contracting Leominster, Mass.	$13.8 million—VA, Coast Guard, Army, Public Buildings Service, National Park Service	• Firm is ineligible because a non-service-disabled veteran manages and controls the firm's daily operations. • During our investigation, firm executives admitted that the service-disabled veteran is not involved with SDVOSB construction contracts. • Service-disabled veteran is an IT specialist who currently works from home on nongovernment contracts. • All the company construction contracts are managed by the non-service-disabled partner of the firm. • The service-disabled veteran does not receive a salary from the company and received less in IRS 1099 distributions than the 10 percent minority owner of the firm. • Ten percent minority owner of the SDVOSB firm is also the president of another construction company located at the same address as the SDVOSB firm.
9	Construction/ maintenance/repair Luthersville, Ga.	$2.8 million—VA, US Coast Guard, USDA, and Army	• Firm is ineligible because a non-service-disabled veteran manages and controls the firm's day-to-day operations and because the SDVOSB firm is a pass-through for a non-SDVOSB firm. • Firm was determined ineligible through an SBA bid protest. • Through interviews and our review of documents submitted by the firm, we found that the SDVOSB firm only has four employees and the owner of a non-SDVOSB firm is responsible for day-to-day operations of SDVOSB contracts. • The SDVOSB firm submitted 10 joint-venture bids within a 5-month period, violating federal regulations. • After being found ineligible by SBA, SDVOSB firm continued to receive approximately $1.8 million in new SDVOSB contracts. • SBA determined the firm was ineligible: however, the firm has not been suspended or debarred from receiving federal contracts.

Case	Industry business location	SDVOSB contracts[a] for years 2003-2009,[b] and awarding agency	Case details
10	Furniture/merchant wholesaler Tampa, Fla.	$900,000—Air Force	• Firm is ineligible because it does not perform any work, and subcontracts 100 percent of the work to non-SDVOSB firms. • Our investigation found that the firm's service-disabled veteran owner works full-time as a DOD contract employee at MacDill Air Force Base—the same location as the contract award. • SDVOSB firm served as a pass-through to a company where the service-disabled veteran's wife works, who passed the work to a furniture manufacturer who designed, delivered, and installed the furniture. • Manufacturer performed planning, design, and installation of contracted goods. • This manufacturer is also on the GSA schedule and could have provided the contracted goods at a significantly lower price. • The firm's physical address is the owner's home and its mailing address is a mail-box rental store. • Contracting officials at MacDill Air Force Base were aware of the pass-through structure of the firm and approved the award knowing that the SDVOSB would not perform the required percentage of work.

Source: GAO analysis of FPDS, ORCA, CCR, contractor data, and interviews.

[a]Obligation amounts are rounded to the nearest $100,000.

[b]Year 2009 amounts are through July 2009.

Case 1: This firm fraudulently certified itself as an SDVOSB in CCR so it could compete for over $200 million in SDVOSB contract awards that FEMA set aside for site maintenance for trailers provided to Hurricane Katrina and Rita victims in Louisiana. In May 2006, the same month as the FEMA request for proposals were posted, the majority owner of the SDVOSB applied for the first time to VA for service-connected disability compensation related to claimed injuries incurred during military service in the mid-1970s. In July 2006, VA requested that the SDVOSB's owner provide evidence of his/her service-connected disability. The owner never responded. In December 2006, the VA denied the owner's application for compensation and status as a service-disabled veteran. Six months later, SBA issued a decision, in response to an SDVOSB status protest, stating that the owner of the firm was not a service-disabled veteran. In its decision, the SBA concluded the SDVOSB firm and its joint venture did not qualify for SDVOSB contracts. Based on this decision, in July 2007, FEMA sent a letter terminating any future task orders for the firm and the joint venture and giving them until the end of August 2007 to cease all operations under both contract awards. In the end, the firm received approximately $7.5 million dollars from FEMA's SDVOSB set-aside contracts prior to termination. The firm received no other punishments or

sanctions for the fraudulent misrepresentation and has not been suspended or debarred from receiving future government contracts.

Case 2: This firm, functioning as a pass-through for non-SDVOSB firms, improperly received over $5 million in SDVOSB contracts. Our investigation revealed that this firm, located in Chico, California, improperly subcontracted 100 percent of the work from an SDVOSB contract to a corporation headquartered in Europe that reported almost $12 billion dollars in revenue in 2008. The firm consists of two owners and three full-time employees. While the majority owner listed on company documents is a service-disabled veteran, neither the owner nor the firm's employees perform any of the work related to SDVOSB contracts the firm receives. SDVOSB janitorial service contracts require that at least half of the personnel costs are incurred by employees of either the firm or another SDVOSB. When we interviewed the firm's service-disabled veteran owner, he/she acknowledged that he/she subcontracted all of the firm's work to other non-SDVOSB firms. The owner said the company's business model is to (1) use Federal Business Opportunities (FedBizOps)[18] to search for SDVOSB set-asides that the firm can find a subcontractor to complete; then (2) take over a portion of the subcontractor's payroll to meet the percentage requirement for completing the work. The owner stated this process was used for the firm's $3.5 million contract for janitorial services at a VA hospital in California, where the SDVOSB firm functioned as a pass-through for a non-SDVOSB foreign-based corporation, which is one of the world's largest facility-service groups, with operations in 50 countries and almost $12 billion in annual revenue in 2008. For this contract, all employees performing the janitorial services were from the foreign-based corporation. The firm—with two owners and only three employees—has secured 21 SDVOSB contracts in nine different states for janitorial, construction, and other services. The work that is passed through to non-SDVOSB firms is valued at $5 million.

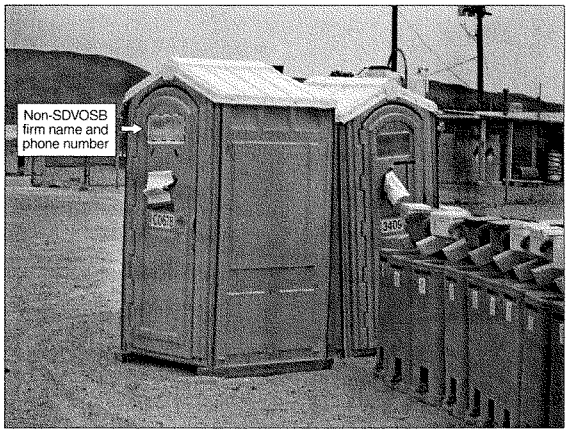
Case 5: Our investigation found that a non-SDVOSB company used two SDVOSB firms as pass-throughs to obtain over $3 million in SDVOSB contracts. It did not have the SDVOSB firms perform the majority of the contract work as required. The company located in Austin, Texas, formed joint ventures with the two SDVOSB firms to receive contracts for septic-

[18]www.FedBizOpps.gov is the U.S. government's Web page for commercial vendors and government buyers to post, search, monitor, and retrieve opportunities solicited by the federal contracting community.

tank and related services from the Army at Fort Drum, New York, and Fort Irwin, California. The Fort Drum set-aside contract was protested in June 2008 through the SBA bid-protest process, which determined that the service-disabled veteran owner was not in control of the business. The SBA disqualified both the non-SDVOSB company and its joint venture from the SDVOSB program and deemed them ineligible to bid on such contracts in the future; however, SBA did not process either the company or the SDVOSB firm for suspension or debarment, which would generally exclude the firms from doing business with the federal government. Furthermore, SBA's ruling did not result in the Army's termination of its contracts with the joint ventures that were the subject of the protest because there are no requirements to terminate contracts awarded to firms ineligible for SDVOSB set-aside or sole-source contracts. The company that used the SDVOSB as a pass-through was allowed to continue to provide septic-tank and related services at Fort Drum through 2013 for a total value of up to $1.1 million.

In 2009 the same non-SDVOSB company from Texas partnered with a different SDVOSB firm to receive a contract at Fort Irwin valued at up to $3 million for septic-tank and related services. Based on our case analysis, the SDVOSB owner does not control the SDVOSB firm. The SDVOSB owner is a former employee of the joint venture "partner" from Texas, as are 8 out of 10 employees. The SDVOSB owner also works 3 days each week at his brother's bar in Illinois—located 1,800 miles away from the project site in California. In addition, the SDVOSB owner does not have control over payments received from the work performed at Fort Irwin. The non-SDVOSB company's accountant, who is located in San Antonio, Texas, manages the SDVOSB firm's bank accounts. Furthermore, a visit to the work site at Fort Irwin in June 2009 also revealed, as shown in figure 1 below, that the portable toilets and hand-wash stations on site all displayed the name and phone number of the non-SDVOSB company.

Figure 1: Case Study 5 Firm's Portable Toilets and Hand-Wash Stations with Non-SDVOSB Name and Phone Number



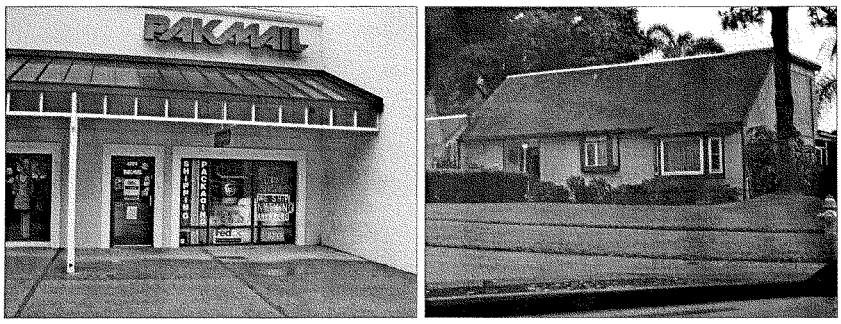
Source: GAO.

In June of 2009 we visited the contract performance site at Fort Irwin, with the intention of inspecting the site unannounced. However, a Fort Irwin contracting officer notified the SDVOSB firm in advance of our site visit. Prior to our arrival it appeared that the SDVOSB owner had made an effort to conceal the true management and control over the contract. Specifically, upon arrival, the SDVOSB owner from Illinois was present on site to greet us, despite the fact that he lived over 1,800 miles away. In addition, a service truck displaying the SDVOSB firm's logo was prominently displayed at the contract location. Further investigation revealed that the truck's registration had been transferred the day of our visit from the non-SDVOSB company from Texas to the SDVOSB firm. However, the registration address remains in Texas at the office of the accountant for both businesses.

Case 10: This case-study firm, functioning as a pass-through for a non-SDVOSB company, received approximately $900,000 for an SDVOSB

contract. Our investigation found that the owner of the SDVOSB passed through all of the work for this furniture design and installation contract to a furniture dealer that his wife worked for, who then passed the work to a furniture manufacturer that actually designed and installed the furniture. When we interviewed the SDVOSB firm owner, he admitted that he had no experience in the furniture business. In addition, the SDVOSB owner works full-time at MacDill Air Force base—the same location as the contract award. This award is questionable on three counts: the SDVOSB owner's full-time job with another employer should make it impossible for him to manage and control daily business operations on a large SDVOSB contract; the contract work was passed through to the manufacturer; and the owner's daily interactions with Air Force personnel on base create the perception of preferential treatment. In addition, as shown in figure 2 below, the legitimacy of the SDVOSB firm is also in question because the firm's physical address is the owner's home and its mailing address is a mail-box rental store.

Figure 2: Business Mailing Address and Physical Address for Case-Study 10 Firm



Source: GAO.

When questioned, contracting officials at the base stated that they were aware that the SDVOSB firm owner was also a DOD contract employee and that he would likely not perform a majority of the work on the contract. Nevertheless, they felt the contract was awarded appropriately.

MacDill Air Force Base awarded the firm, which has no employees, an SDVOSB set-aside contract for approximately $900,000 for furniture layout design, delivery, and installation. The SDVOSB firm owner has worked at the base for over 20 years as a telecommunications contract employee. The base director of contracting and the legal counsel who approved the award had prior working relationships with the SDVOSB owner on the base. Contracting officials told us that during the decision process for the award of the furniture contract, heavy emphasis was placed on past performance rather than price; however, the SDVOSB firm had no past-performance history. Contracting officials at the base instead allowed the SDVOSB firm to use past performance ratings of the furniture dealer, where the owner's wife worked to meet the past-performance requirement.

In addition, contracting officials were aware of the SDVOSB owner's limited involvement in performing the contract. They even stated that the service-disabled veteran would likely not show up until it was time to collect his check. The military personnel in charge of overseeing the furniture layout design, delivery, and installation stated that the manufacturer was more involved than the SDVOSB or its affiliate dealer. We observed the delivery and installation of some of the furniture related to this contract. The manufacturer was the only company present to lead the installation process, with the plans they designed in-hand and their logo clearly printed on them. Despite the fact that this SDVOSB award clearly functioned as a pass-through for a non-SDVOSB firm, base officials did not consider the award to be improper. In fact, the Director of Contracting at the base stated that he estimates 90 percent of SDVOSB contracts are pass-throughs for non-SDVOSB companies.

SDVOSB Program Does Not Have Governmentwide Fraud-Prevention Controls

The 10 case studies discussed above show that significant control weaknesses in the SDVOSB program allow ineligible firms to receive millions in SDVOSB contracts. The lack of effective fraud-prevention controls by SBA and agencies awarding contracts allowed these ineligible firms to receive approximately $100 million of sole-source or set-aside SDVOSB contracts over the last several years. The SDVOSB program is essentially an eligibility-based program. However, neither the SBA, except when responding to a protest, nor contracting officials are currently verifying the eligibility of firms claiming to be SDVOSBs. For example, currently the SBA and contracting agencies do not have a process in place to access the VA service-disabled veteran's database listing individuals that are valid service-disabled veterans. In addition, contracting officers are not required to validate that a firm's owner is a service-disabled

veteran prior to award. Unlike other small business contracting programs, such as the HUBZone and 8(a) programs, there also are no documentation submissions to substantiate eligibility for the program or application process associated with the SDVOSB program. This lack of controls substantially increases the risk for fraud and abuse in the SDVOSB program.

The only process in place to detect fraud in the SDVOSB program involves a formal bid protest process at the SBA, whereby interested parties to a contract award can protest if they feel a firm misrepresented its small business size or SDVOSB eligibility in its bid submission. However, as shown by our case studies, this self-policing process does not prevent ineligible firms from receiving SDVOSB contracts. For example, bid-protest decisions do not always result in the termination of contracts with ineligible firms, even when termination costs would be minimal in cases where contract work had not begun. As some of our case studies show, even when firms are found ineligible to receive a contract, they can still retain it because current regulations do not require that the contracting agency terminate the contract. In addition, none of the firms found ineligible by the SBA through SDVOSB-status protests were suspended or debarred from receiving SDVOSB and other government contracts. When asked about its bid protest process, SBA officials stated that the bid protest process focuses on determining the eligibility of a firm for a specific contract and providing details on why a firm was found to be eligible or ineligible. SBA officials also stated that bid protest decisions do not include recommendations for suspension or debarment. Recently, in response to the Veterans Benefits, Health Care, and Information Technology Act,[19] VA has taken steps to develop a validation program for contracts it awards to SDVOSBs and Veteran-Owned Small Businesses (VOSB). While not yet fully implemented,[20] this validation program includes steps to verify a firm's eligibility for the program including validating an owner's SDV status and his/her control of day-to-day operations. The VA program also includes plans for site visits to firms seeking VA certification as an SDVOSB or VOSB.

[19]Veterans Benefits, Heath Care, and Information Act of 2006, Pub. L. No. 109-461, 120 Stat. 3433 (2006).

[20]See GAO, *Department of Veterans Affairs Contracting with Veteran-Owned Small Businesses*, GAO-09-391R (Washington, D.C.: Mar. 19, 2009).

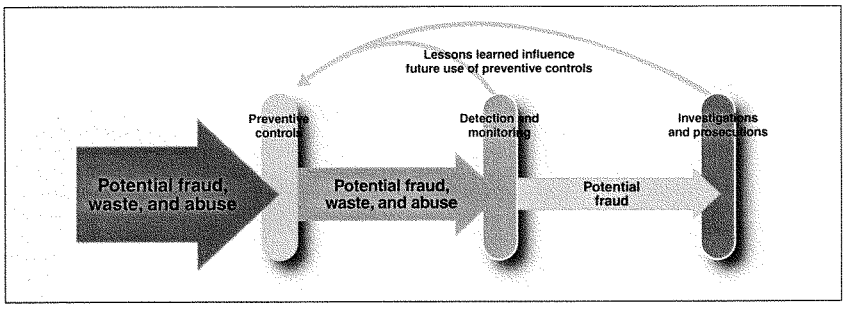
Lack of Governmentwide Fraud-Prevention Controls Leaves the Government Vulnerable to Fraud and Abuse

Our 10 case studies clearly show that fraud and abuse exist within the SDVOSB program. Without preventive controls our case studies show that millions of dollars of SDVOSB set-aside and sole-source contracts are being awarded to ineligible firms. Fraud prevention requires a system of rules which, in their aggregate, minimize the likelihood of fraud occurring while maximizing the possibility of detecting any fraudulent activity at a reasonable cost. Fraud-prevention systems set forth what actions constitute fraudulent conduct and specifically spell out who in the organization handles fraud matters under varying circumstances. The potential of being caught and disciplined can, in some cases, persuade likely perpetrators not to commit the fraud. Because of this principle, the existence of a thorough fraud-prevention system is essential to fraud prevention and detection.[21] However, as shown by our case studies, there are at times no consequences for firms that fraudulently misrepresent their status as SDVOSBs or otherwise abuse the current system. Not only are firms not prosecuted, suspended, or debarred, but in many cases, because there is no requirement for agencies to terminate contracts awarded to ineligible firms, the firms are allowed to continue performing contracts, even when contract termination costs would be minimal in cases where contracted work had not begun. In addition, ineligible firms in some instances continue bidding on SDVOSB contracts without consequences.

As of July 2009, the federal government does not have in place the key elements of an effective fraud-prevention system for the SDVOSB program. As shown in figure 3 below, a well-designed fraud-prevention system should consist of three crucial elements: (1) up-front preventive controls, (2) detection and monitoring, and (3) investigations and prosecutions. For the SDVOSB program this would mean (1) front-end controls over program eligibility prior to contract award, (2) fraud detection and monitoring of firms already receiving SDVOSB contracts, and (3) the aggressive pursuit and prosecution of individuals committing fraud to include suspension and debarment, or requirement to terminate the contract. In addition, as shown in figure 3, the organization should also use "lessons learned" from its detection and monitoring controls and investigations and prosecutions to design more-effective preventive controls.

[21]Association of Certified Fraud Examiners, *Fraud Examiners Manual*, U.S. Edition (2007).

Figure 3: Fraud-Prevention Model



Source: GAO.

Preventive Controls

Currently the SDVOSB program has no preventive controls in place to prevent fraud and abuse in the program. In addition, the SBA and agencies awarding contracts do not have access to a database listing individuals that are valid service-disabled veterans. We have previously reported that fraud prevention is the most efficient and effective means to minimize fraud, waste, and abuse.[22] This is especially important in a program like the SDVOSB program where even firms identified as receiving contracts through fraud or abuse face no real consequences as discussed below. Thus, controls that prevent fraudulent firms and individuals from entering the program in the first place are the most important element in an effective fraud-prevention program. The most crucial element of effective fraud-prevention controls is a focus on substantially diminishing the opportunity for fraudulent access into the system through front-end controls. Currently there are no preventive controls in place for the SDVOSB program. The SDVOSB program is essentially an eligibility-based program. However neither the SBA or contracting officials are required to

[22]GAO, *HUBZone Program: Fraud and Abuse Identified in Four Metropolitan Areas*, GAO-09-440 (Washington, D.C.: Mar. 25, 2009); *Hurricanes Katrina and Rita Disaster Relief: Prevention Is the Key to Minimizing Fraud, Waste and Abuse in Recovery Efforts*, GAO-07-418T (Washington, D.C.: Jan. 29, 2007); and *Individual Disaster Assistance Programs: Framework for Fraud Prevention, Detection, and Prosecution*, GAO-06-954T (Washington, D.C.: July 12, 2006).

verify the eligibility of firms claiming to be SDVOSBs. This lack of controls substantially increases the risk for fraud and abuse in the SDVOSB program.

Detection and Monitoring

Although preventive controls are the most effective way to minimize fraud and abuse, continual monitoring is an important component in detecting and deterring fraud. Monitoring and detection within a fraud-prevention program involve actions such as data mining for fraudulent and suspicious applicants and evaluating firms to provide reasonable assurance that they continue to meet program requirements. Currently, the only process in place that can detect fraud and abuse in this program is the bid-protest process administered by SBA. Through the bid-protest process, interested parties self-police the SDVOSB program by exercising their right to challenge an SDVOSB award that is suspected to have been awarded to an ineligible firm. SBA will determine the eligibility of the firm, and if ruled ineligible, the SBA protest decision will state that the firm is supposed to be ineligible for additional SDVOSB awards. However, based on our case studies this process does not prevent the firms from bidding on SDVOSB contracts, because SBA protest decisions are not listed in CCR or ORCA, and therefore contracting officials may not be aware of protest decisions. Officials from the Inspector General offices within SBA and VA stated that they will respond to allegations of fraud and abuse within the SDVOSB program, but they do not actively monitor the program for fraud and abuse. Without continual monitoring of the program, the risk for persistent fraud and abuse increases.

Investigation and Prosecution

The final element of an effective fraud prevention system is the aggressive investigation and prosecution of individuals who commit fraud against the federal government. The SBA, through the bid-protest process, makes determinations of eligibility status in the SDVOSB program. However, there is not an effective process for prosecution, suspension, or debarment of program abusers. Without consequences, the bid-protest process is not an effective control for preventing future abuse. As mentioned in case studies above, firms determined to be ineligible for SDVOSB awards are not required to terminate those awards. In one case, a joint venture was determined to be a pass-through—it completed the contract and created another pass-through with a different service-disabled veteran to win another SDVOSB contract. Furthermore, although SBA's regulations[23] state that firms misrepresenting themselves as SDVOSB concerns may be

[23] 13 CFR § 125.29.

suspended or debarred from government contracting and may suffer civil and criminal penalties for knowingly making false statements to the SBA, to-date, the SBA program office has never referred any firms for debarment or suspension proceedings, or both, based on SBA findings from its program-eligibility reviews. When asked about its bid protest process, SBA officials stated that the bid protest process focuses on determining the eligibility of a firm for a specific contract and providing details on why a firm was found to be eligible or ineligible. SBA officials also stated that bid protest decisions do not include recommendations for suspension and debarment. By failing to hold firms accountable, SBA and contracting agencies have sent a message to the contracting community that there is no punishment or consequences for committing fraud or abusing the intent of the SDVOSB program.

VA Is Developing Controls for Its SDVOSB Contracts

The Veterans Benefits, Health Care, and Information Technology Act[24]—which took effect in June 2007—requires VA to maintain a database of SDVOSBs and Veteran Owned Small Businesses (VOSB) so contractor eligibility can be verified. It also requires the VA to determine whether SDVOSBs and VOSBs are indeed owned and controlled by veterans or service-disabled veterans in order to bid and receive VA contracts. Lastly, it requires VA set-aside and sole-source awards be made only to firms that have had their eligibility verified. Currently these controls are being developed to validate eligibility for awarding VA contracts only.

At the time the act took effect, VA already maintained an online database, VetBiz Vendor Information Pages, referred to as VA's VetBiz database, in which nearly 16,500 firms had self-certified as SDVOSBs or VOSBs. VA began accepting applications to validate eligibility for the SDVOSB program from firms registered in the database in May 2008, after it published guidelines for the verification program in an interim final rule.[25] To date, VA's validation process has focused on cross-referencing information submitted by owners with the agency's own data to confirm majority ownership by veterans or service-disabled veterans. VA also expects to pilot procedures for more detailed reviews of selected firms to verify day-to-day control by a service-disabled or other veteran. According to VA officials, the agency will begin requiring its contracting officers to

[24]Veterans Benefits, Heath Care, and Information Act of 2006, Pub. L. No. 109-461, 120 Stat. 3433 (2006).

[25]73 *Fed. Reg.* 29024 (May 19, 2008).

use the set-aside and sole-source award authorities only with verified SDVOSBs and VOSBs after the agency finalizes rule making related to implementation of these authorities. As of March 2009, these program controls have not been implemented. Until this new program becomes operational, existing VA policy states that firms only have to be registered in VA's database to receive set-aside or sole-source awards. Currently there are no plans to implement these controls governmentwide.

Additional controls that VA plans to develop include its own certification process for prospective SDVOSB businesses. The process is to include a review of documents, validation of the owner's status as a service-disabled veteran, and potential site visits to businesses bidding on VA SDVOSB contracts. Requiring submission of documents to demonstrate ownership and control of an SDVOSB has some value as a deterrent—ownership documents could have prevented instances demonstrated in our case studies where the service-disabled veteran was receiving less than 51 percent of the profits. The most effective preventive controls involve the verification of information, such as verifying service-disabled status with the VA's database and service-disabled veteran participation in the business through an unannounced site visit. Verification of service-disabled veteran status by using the VA's database could have prevented the most egregious example of fraud where the owner was not even a service-disabled veteran. Although VA's proposed system was not intended for governmentwide use, once the certification system is in place, all SDVOSBs wishing to do business with VA will have to be certified.

Conclusions

The SDVOSB program does not have effective governmentwide fraud-prevention controls in place and is vulnerable to fraud and abuse. In just the 10 cases we show in this report, the consequences of this lack of control include approximately $100 million of sole source and set aside SDVOSB contracts to companies that have figured out how to manipulate the current system. Even the few companies identified as ineligible through the bid-protest system face no real consequences, in times being allowed by the government to complete the contract they obtained through fraudulent representations. Victims of the fraud and abuse in this program are the legitimate service-disabled veterans and their firms. SBA's only requirement is a "self-certification" process, whereby SDVOSB concerns self-certify their eligibility. However, VA has begun to develop a process for certifying the eligibility of SDVOSB firms prior to contract award, but that process currently only relates to firms bidding on VA SDVOSB contracts. To address governmentwide vulnerabilities we identified, an effective governmentwide process is necessary to certify the

eligibility of all firms bidding on SDVOSB contracts. To be effective, this process should include coordination between the different agencies with the authority to improve program controls, and some form of punishment, such as prosecution, suspension, and debarment of fraudulent individuals and their companies.

Matter for Congressional Consideration

Our work documents numerous cases where the current governmentwide self-certification system over the SDVOSB program has allowed ineligible firms to receive millions of dollars in federal contracts. However, through the Veterans Benefits, Health Care, and Information Technology Act of 2007, Congress required VA to maintain a database of SDVOSBs, determine whether SDVOSBs are indeed owned and controlled by service-disabled veterans, and required VA set-aside and sole-source awards be made only to firms that have had their eligibility verified. Currently, the only efforts to put fraud prevention controls in place are at VA through their VetBiz program, which applies only to VA contracts. Given that outside of VA there is no verification program in place for SDVOSB contracting, Congress should consider providing VA with the authority and resources necessary to expand its SDVOSB eligibility verification process to all contractors seeking to bid on SDVOSB contracts governmentwide.

Recommendations for Executive Action

In an effort to minimize the potential for fraud and abuse in the Service-Disabled Veteran-Owned Small Business (SDVOSB) program and to assure that legitimate service-disabled veterans and their firms reap the benefits of this program, we recommend that the Administrator of the Small Business Administration (SBA) and the Secretary of the Veterans Affairs (VA) coordinate with the Office of Federal Procurement Policy (OFPP) to explore the feasibility of

- expanding the use of the VA VetBiz "verified" database governmentwide for purposes of validating all SDVOSB eligible firms for contracting and,
- requiring that all contractors who knowingly misrepresent their status as an SDVOSB be debarred for a reasonable period of time.

In addition, we recommend the Administrator of SBA refer all SDVOSB firms that submit misrepresentations of their status to SBA's Office of Inspector General for review and further investigation.

Agency Comments and Our Evaluation

SBA and VA provided general observations and technical comments in response to a draft of this report. They also responded directly to our recommendations. Their responses are included in appendixes II and III. We have made revisions based on the observations and technical comments where appropriate. In response to our recommendations, VA generally agreed with our two recommendations. In its response VA expressed that specific authority would be required for other agencies to be able to rely on the department's VetBiz database and exclude firms from acquisitions if not "verified" in this database. We recognize that additional authority may be required for other federal agencies to rely on certifications made in VA's VetBiz database, and have raised this issue in our matter for congressional consideration. In addition, VA stated that governmentwide applicability of authority for federal agencies, other than VA, to initiate debarment actions related to acquisitions for any firms that misrepresent information on the status of that firm as a small business owned and controlled by veterans or service-disabled veterans would require OFPP to seek a revision to the Federal Acquisition Regulation to add SDVOSB status misrepresentation as a cause for debarment. Our recommendation concerning coordination between VA, SBA, and OFPP addresses this concern.

SBA's response, provided by the Associate Administrator for Government Contracting and Business Development, generally agreed with our recommendations; however, in its general observations and specific responses to our recommendations, SBA stated that they have limited responsibilities over the SDVOSB program and questioned the efficacy of one of our recommendations. Specifically, SBA stated that agency contracting officers bear the primarily the responsibility for ensuring only eligible SDVOSB firms perform SDVOSB set aside and sole source contracts. SBA also stated it is only authorized to perform eligibility reviews in a bid protest situation, and contracting officers, not SBA, are responsible for taking appropriate action after a bid protest decision is made. The Associate Administrator maintained that SBA was under no legal obligation to create a protest process for the SDVOSB program, and that its only statutory obligation is to report on other agencies' success in meeting SDVOSB contracting goals. In addition, SBA expressed that it was not obligated to institute any type of fraud prevention controls within the SDVOSB program.

While we acknowledge that there are shared responsibilities between SBA and agency contracting officers when attempting to prevent fraud in the SDVOSB program, we do not agree that SBA does not have responsibility or authority to develop and implement a process to provide reasonable

assurance that only eligible SDVOSB firms are awarded set aside and sole source SDVOSB contracts. Specifically, its statutory responsibilities date back to December 2003, when the Veterans Benefits Act of 2003 amended the Small Business Act to provide that "[r]ules similar to the rules of paragraphs (5) and (6) of Section 8(m)" shall apply to the SDVOSB program.[26] Indeed, in an interim final rule implementing that section of the act, SBA acknowledged that it is statutorily authorized to administer the SDVOSB program.[27] Classified to section 637 of Title 15 of the United States Code, the provisions in section 8(m) of the Small Business Act specifically require the Administrator of SBA to establish procedures relating to the "filing, investigation, and disposition of any challenge of the eligibility of a small business concern ... and the verification ... of the accuracy of any certification made or information provided to the Administrator by a small business."[28] To implement these verification procedures, SBA is authorized to conduct program examinations, including random examinations, of any certification made or information provided to the Administrator.[29] To carry out its verification responsibilities, SBA is authorized to obtain information from any federal agency or department that the Administrator determines is necessary.[30] In the event that the Administrator determines that an entity has misrepresented its status, that entity is subject to certain penalties.[31] Given this specific legislative authority and responsibility, we believe that, contrary to its assertion, SBA has an obligation to assist in development and implementation of a verification process for the SDVOSB program to provide reasonable assurance that sole source and set aside SDVOSB contracting opportunities are only provided to eligible SDVOSB firms.

In response to our first recommendation, SBA questioned the efficacy of expanding the use of VA's VetBiz verified database governmentwide to verify the eligibility of SDVOSB firms for the program because of the self-certification nature of the program. We believe that the expansion of VA's

[26]Pub. L. No. 108-183, § 308, 117 Stat. 2651, 2662 (2003), 15 U.S.C. § 657f.

[27]Small Business Size Regulations; Government Contracting Programs, 69 Fed. Reg. 25,262, 25,265 (May 4, 2004).

[28]15 U.S.C. § 637(m)(5)(A).

[29]15 U.S.C. §637(m)(5)(B).

[30]15 U.S.C. §637(m)(6).

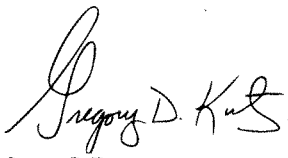
[31]15 U.S.C. § 637(m) (5) (C).

verification process to all SDVOSB contractors attempting to bid on federal contracts would provide assurances that only eligible SDVOSB firms receive the benefits of the special contract opportunities established by the SDVOSB program. We believe this verification is especially important given that the current set of controls over the SDVOSB program consist primarily of self-certifications made by contractors, as SBA represented in their response to a draft of this report. In SBA's other response to our first recommendation, SBA stated that it is the contracting officer's responsibility to enforce or pursue suggested penalties for firms who knowingly misrepresent their status as an SDVOSB firm. As stated above, we agree that there is a shared responsibility for prevention, detection, and punishment of fraud and abuse in the program between agency contracting officers and the SBA.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the date of this letter. We will then send copies of this report to interested congressional committees, the Administrator of SBA, the Secretary of VA, and other interested parties. The report will also be available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff members have any questions about this report, please contact me at (202) 512-6722 or kutzg@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix IV.

Sincerely Yours,



Gregory D. Kutz
Managing Director
Forensic Audits and Special Investigations

Appendix I: Scope and Methodology

To identify examples of firms that received Service-Disabled Veteran Owned Small Business (SDVOSB) contracts through fraudulent or abusive eligibility misrepresentations, we reviewed SDVOSB contract awards and protests filed with the Small Business Administration (SBA) since the programs inception in 2003. We also reviewed allegations of fraud and abuse sent to our fraud hotline, FraudNET. In addition, we posted inquiries on our Web page and on various veteran advocacy-groups' Web pages and newsletters seeking information on fraud or abuse of the SDVOSB program. We received over 100 allegations of fraud and abuse in the SDVOSB program. From these sources, we selected 10 cases for further investigation based on a variety of factors, including facts and evidence provided in protests and allegations, whether a firm received multiple SDVOSB contracts, and whether a firm received other non-SDVOSB contracts. For the purposes of our investigation, we defined a case as one or more affiliated firms or joint ventures that obtained an SDVOSB contract. These cases include multiple firms owned by an individual or multiple firms affiliated through joint ventures and other types of partner agreements. To investigate these case studies, we interviewed firm owners and managers and reviewed relevant documentation, such as business filings and tax returns, to determine if SDVOSB eligibility requirements had been met. We also analyzed data from Federal Procurement Data System–Next Generation (FPDS-NG) for years 2003 through 2009 to identify SDVOSB contracts received by the firms since the program's inception. Furthermore, we reviewed certifications made by firms, such as certifications about a firm's size, SDVOSB status, and line of business, in the federal government's Online Representations and Certifications Application (ORCA). To assess overall program vulnerabilities, we reviewed relevant laws and regulations governing the SDVOSB program. Our work was not designed to identify all firms that misrepresent themselves as SDVOSBs or commit fraudulent or abusive activity in the SDVOSB program. Our work also did not attempt to identify fraud and abuse in SDVOSB subcontracts. Our work focused on determining whether selected firms met program eligibility requirements. In addition, our 10 case-study examples cannot be projected to the overall population of SDVOSB firms.

To determine whether the program has effective fraud-prevention controls in place, we interviewed agency officials from SBA, the Department of Veterans Affairs (VA), and various agency contracting officials about their responsibility over the program and controls currently in place to prevent, detect, and monitor fraud and abuse. We also reviewed information from the Federal Register—The President's Executive Order, the Federal Acquisition Regulation (FAR), United States Code, and SBA guidance on

government contracting programs to determine the extent to which SBA and awarding agencies are required to verify contractor eligibility for SDVOSB contracts. Furthermore, we compared current controls in the SDVOSB program to a fraud-prevention model developed by GAO and utilized in prior small business contracting investigations.

Appendix II: Comments from the Small Business Administration

Note: Page numbers in the draft report may differ from those in this report.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

August 20, 2009

Mr. Gregory D. Kutz
Managing Director
Forensic Audits and Special Investigations
U.S. Government Accountability Office
441 G. Street, N.W.
Washington, DC 20548

Dear Mr. Kutz,

The U.S. Small Business Administration (SBA) appreciates the opportunity to provide comments on the Government Accountability Office's (GAO) draft report entitled "Service Disabled Veteran Owned Small Business (SDVOSB) Program: Cases Show Fraud and Abuse Allowed Ineligible Firms to Obtain Millions of Dollars in Contracts (GAO-09-929)."
The SDVOSB Program is an important procurement program that helps to achieve the Government's goal of distributing federal contract dollars to small businesses. Further, it honors the extraordinary service rendered to the United States by veterans with disabilities incurred or aggravated in the line of duty. In FY 2007, $4 billion in federal contracts were awarded to SDVOSB qualified firms.

The SBA is dedicated to providing the highest quality service, transparency, and accountability. In the same vein, we would like to acknowledge our duty and commitment to eliminate fraud, waste and abuse in any of our programs. That said, we believe the draft report includes some misrepresentations of the SBA's responsibilities with regard to the program as well as some technical errors. We would like to submit the following observations/recommendations:

General Observation:
While the SBA shares responsibility with other Agencies (e.g. Veteran Administration) for ensuring the integrity of the overall program, it is ultimately the federal agency's Contracting Officers who administer the individual contracts and have the primary accountability for ensuring that only bona-fide SDVOSB firms perform these contracts.

The SBA's responsibility lies in the formal bid protest process, whereby interested parties to a contract award can protest if they have credible evidence that a firm misrepresented its SDVOSB eligibility. If a firm is deemed not eligible via this process, the Contracting Officer then becomes responsible for halting contract disbursements and taking any further action against the firm. Moreover, the statute and regulations related to the SDVOSB program allow for self-certification. The SBA is only authorized to perform eligibility reviews in a protest situation, including those cases where the SBA itself has reason to believe that a firm has misrepresented its SDVOSB status. In this area, the SBA believes it has been diligent and responsible as all

Mr. Gregory D. Kutz
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protest determinations have been provided to the appropriate Contracting Officer in a timely manner. The statutes and regulations dictate that it is then incumbent upon the Contracting Officer to take appropriate action when notified by the SBA subsequent to a protest that a firm is not eligible to claim status as an SDVOSB.

It should also be noted that after a contract has been awarded, it is the Contracting Officer's responsibility to ensure that the firm is complying with the applicable limitations on subcontracting provisions. If the Contracting Officer suspects that the firm may not comply with these provisions prior to the award, only then would the SBA get involved via the certificate of competency program.

Technical Observations/Recommendations
Incorporating the above general observation, we recommend the following changes to the draft report:

Highlight Page

- Draft Report: Specifically, SBA and agencies awarding SDVOSB contracts do not have processes in place to validate a firm's eligibility for the program.

  SBA's recommendation: Specifically, SBA and agencies awarding SDVOSB contracts do not have processes in place to validate a firm's eligibility for the program prior to bid submission.

Page 1

- Draft Report: The statutorily-mandated prime contracting goal for SDVOSB participation is 3 percent of all federal contract dollars.

  SBA's recommendation: The statutorily-mandated prime and sub contracting goal for SDVOSB participation is not less than 3 percent of all federal contract dollars.

Page 2

- Draft Report: The statutorily-mandated prime contracting goal for SDVOSB participation is 3 percent of all federal contract dollars.

  SBA's recommendation: The statutorily-mandated prime and sub contracting goal for SDVOSB participation is not less than 3 percent of all federal contract dollars.

The draft report states the SBA administers the SDVOSB program. This is incorrect. Instead, each procuring activity administers the SDVOSN program. The Veterans Benefits Act of 2003 (Pub. L. No. 108-183) gives SBA no more power to oversee the SDVOSB program than any other agency. We recommend either removing this

Mr. Gregory D. Kutz
Page 3 of 5

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- statement or changing it to read "...which, along with all federal procuring activities, administers the SDVOSB."

- The draft report states that "...the government has not met its annual mandated goal" with regard to the percentage of federal procurement opportunities being awarded to SDVOSBs. While it is true that the government as a whole has not met the 3% minimum requirement, several individual agencies have met this goal.

Page 6

- The draft report discusses abuses whereby firms act as "pass throughs" for large and sometimes foreign corporations. After a contract award is made to an SDVOSB firm as the result of a sole source or set-aside award, it is the federal agency's Contracting Officer's responsibility for ensuring that the firm is complying with the applicable Limitations on Subcontracting (LOS) provisions.

Page 8

- In discussing Case 1, the report states that the firm didn't receive any other punishments/sanctions for its fraudulent actions and notes that the firm has not been suspended or debarred from receiving future government contracts. Although it's noted in the report table, the case write-up should mention that the firm was determined ineligible by the SBA in a protest action. At this point it then becomes the FEMA Contracting Officer's responsibility to propose the firm for debarment or suspension as that agency was 'harmed' by the firm's actions. This rationale is also applicable for the case details of Case 3, Case 5 and Case 9.

- In Case 2, GAO's investigation determined that the firm improperly subcontracted 100% of the work to an international corporation. Again, contract administration is the responsibility of the Agency and the Contracting Officer responsible for that contract. This rationale is also applicable for the case details of Case 4, Case 7, Case 8 and Case 10.

Page 17 & 18

- The GAO draft report faults SBA for demonstrating a lack of effective fraud prevention controls. However, changes made to the Small Business Act by the Veterans Benefits Act of 2003 do not reference any fraud prevention authority or responsibility on SBA. The SBA's only statutory obligation with regard to the SDVOSB program is our duty to report on other agencies success toward meeting the 3% minimum requirement for contracting with SDVOSBs.

  It should be noted, however, that the SBA, acting on its own initiative, instituted the SDVOSB bid protest process for the following reason as stated in the preamble to the publication of the Agency's SDVOSB regulations:

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> Because SDVOSBs will be attesting to their eligibility at the time of offer, and not through a certification process established by the SBA, it is important to have some mechanism to check eligibility for the receipt of a contract issued as a sole source or set-aside for SDVOSBs. [Small Business Size Regulations; Government Contracting Programs, 69 Fed. Reg. 25,264 (May 5, 2004)]

SBA was under no legal obligation to create a protest process for SDVOSB procurements. As the Agency observed in the regulatory preamble, unlike the statutes that created the HUBZone and 8(a) Business Development programs, the Veterans Benefits Act of 2003 did not include any discussion of program certification. [Id. at 25,265] Moreover, SBA receives no funding from either Congress or other agencies to cover the considerable cost that would be incurred for administering a SDVOSB certification process. However, because the Agency was concerned about the potential that existed for fraud on the part of firms improperly claiming SDVOSB status, SBA voluntarily stepped into the regulatory void and created the bid protest process in order to avoid having this procurement process go entirely un-policed.

- Further we would suggest changing the sentence:
  Draft Report: However, neither the SBA nor contracting officials are currently verifying the eligibility of firms claiming to be SDVOSBs.

  SBA's recommendation: However, neither the SBA, except when responding to a protest, or contracting officials are currently verifying the eligibility of firms claiming to be SDVOSBs.

With regards to the draft reports two recommendations for executive action, the SBA is submitting the following responses:

Recommendation #1
The Administrator of the Small Business Administration (SBA) and the Secretary of the Veterans Affairs (VA) coordinate with the Office of Federal Procurement Policy (OFPP) to explore the feasibility of

- Expanding the use of the VA VetBiz "verified" database government-wide for purposes of validating all SDVOSB eligible firms for contracting and,
- Requiring that all contractors who knowingly misrepresent their status as an SDVOSB be debarred for a reasonable period of time.

Response:
The SBA generally agrees that coordination among itself, VA and OFPP should occur to address the issues of fraud and abuse associated with the SDVOSB program. However, given the self-certification nature of the program, we question the efficacy of expanding the VA VetBiz database government-wide for verification purposes in detecting fraud, waste and abuse.

Mr. Gregory D. Kutz
Page 5 of 5

In response to the second bullet point, the SBA agrees that firms that knowingly misrepresent their status as an SDVOSB, and were found to do so via the bid protest process, should face consequences. As such, the SBA will submit a recommendation to the IAE to identify the penalties for such an infraction. However, it is the responsibility of the Contracting Officer to enforce or pursue those suggested penalties.

Recommendation #2
The Administrator of the SBA refers all SDVOSB firms that submit misrepresentations of their status to the Office of Inspector General for review and further investigation.

Response:
The SBA agrees that when the Agency determines via the protest process that a firm knowingly has misrepresented its SDVOSB status with the intent to fraudulently obtain a federal contract, SBA should continue its longstanding practice of referring the firm to the Office of Inspector General for review and further investigation.

If you have any questions, please do not hesitate to contact us.

Sincerely,

Joseph G. Jordan
Associate Administrator
for Government Contracting
and Business Development

Appendix III: Comments from the Department of Veterans Affairs

Department of Veterans Affairs
Office of the Secretary

August 27, 2009

Mr. Greg Kutz
Managing Director, Forensic Audits
and Special Investigations
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Mr. Kutz:

The Department of Veterans Affairs (VA) has reviewed the Government Accountability Office's (GAO) draft report, ***SERVICE DISABLED VETERAN OWNED SMALL BUSINESS PROGRAM: Case Studies Show Fraud and Abuse Allowed Ineligible Firms to Obtain Millions of Dollars in Contracts*** (GAO-09-929) and generally agrees with GAO's conclusions and concurs with GAO's recommendations to the Department.

The enclosure specifically addresses GAO's recommendations. VA appreciates the opportunity to comment on your draft report.

Sincerely,

John R. Gingrich
Chief of Staff

Enclosure

Enclosure

DEPATMENT OF VETERANS AFFAIRS (VA) COMMENTS TO GAO DRAFT REPORT, ***SERVICE DISABLED VETERAN OWNED SMALL BUSINESS PROGRAM: Case Studies Show Fraud and Abuse Allowed Ineligible Firms to Obtain Millions of Dollars in Contracts*** (GAO-09-929)

GAO recommendation: In an effort to minimize the potential for fraud and abuse in the Service-Disabled Veteran-Owned Small Business (SDVOSB) program and to assure that legitimate service-disabled veterans and their firms reap the benefits of this program, we recommend that the Administrator of the Small Business Administration (SBA) and the Secretary of Veterans Affairs (VA) coordinate with the Office of Federal Procurement Policy (OFPP) to explore the feasibility of:

Recommendation 1: expanding the use of VetBiz "verified" database governmentwide for purposes of validating all SDVOSB eligible firms for contracting.

VA comments to the draft report: Concur. VA will work with SBA and with OFPP to explore the feasibility in expanding the use of VetBiz. VA agrees that it may be effective for the Department to expand use of the VetBiz database to help identify firms eligible for the SDVOSB program and minimize the likelihood of fraud. However, specific authority would be required for other agencies to be able to rely on the Department's VetBiz database and exclude firms from acquisitions not so "verified." OFPP and SBA would have to determine whether that could be effectuated by amendment to the Federal Acquisition Regulation or whether a new statutory provision would be required.

Recommendation 2: requiring that all contractors who knowingly misrepresent their status as an SDVOSB be debarred for a reasonable period of time.

VA comments to the draft report: Concur in principle. The Department has specific authority to initiate debarment actions related to VA acquisitions for any company that misrepresents information on the status of that concern as a small business owned and controlled by Veterans or service-disabled Veterans at 38 U.S.C. 8127(g). Also, the VA's Verification Program regulation, 38 CFR 74.2(c), requires VA's Center for Veterans Enterprise to refer applicants determined to have submitted false information to VA's Office of Inspector General for review and to request that debarment proceedings be initiated by the Department against the concern. Governmentwide applicability of such authority would require, at a minimum, OFPP to seek a revision to the Federal Acquisition Regulation (48 CFR 9.406-2, Causes for debarment) to add SDVOSB status misrepresentation as a cause for debarment.

Appendix IV: GAO Contact and Staff Acknowledgments

GAO Contact

Gregory D. Kutz, Managing Director, (202) 512-6722, kutzg@gao.gov

Staff Acknowledgments

In addition to the individual named above, Gary Bianchi, Bruce Causseaux, Randy Cole, Victoria De Leon, Ken Hill, John Ledford, Deanna Lee, Barbara Lewis, Vicki McClure, Jonathan Meyer, Andrew O'Connell, George Ogilvie, Gloria Proa, Barry Shillito, and Abby Volk also provided assistance on this report.

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Congressional Relations	Ralph Dawn, Managing Director, dawnr@gao.gov, (202) 512-4400 U.S. Government Accountability Office, 441 G Street NW, Room 7125 Washington, DC 20548
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U.S. Small Business Administration

Recovery Act Report Card

October 2009

PRELIMINARY

SBA
U.S. Small Business Administration

SBA Recovery Act Highlights

- **In October 2008, credit markets, including SBA's, froze, and the SBA secondary market slowed dramatically.**
- **On March 16, SBA implemented two critical Recovery Act provisions:**
  - 90% guarantees on 7(a) loans, and
  - Fee reductions in both the 7(a) and 504 programs.
- **These provisions have helped drive significantly improved loan volumes from the depths of the crisis.**
  - ***Expanded access to capital:*** : As of October 30, SBA approved[1] $10.2 billion in Recovery loans, and supported $13.9 billion in lending to small businesses[2].
  - ***New lenders:*** From Feb. 17 to September 30, over 1,260 lenders that had not previously made a loan since Oct. 2008 made 7(a) or ARC loans. As of October 30, there were over 840 who had not made a loan since at least 2007.
  - ***Recovered volumes:*** Since the signing of ARRA, weekly loan dollar volumes have risen 76% in the 7(a) and 504 programs, compared to the weeks preceding ARRA's passage[3]. September 2009's gross 7(a) and 504 approval volume was SBA's highest loan volume since August 2007
  - **Broad-based support:** A significant share of loans supported by Recovery Act funding has gone to rural (27%), minority-owned (20%), women-owned (19%), and veteran-owned (9%) businesses[4]
  - ***SBA has implemented the ARC loan program*:** As of November 1, SBA approved 3,767 loans totaling over $122 million[5].
- **The secondary market has also recovered.**
  - ***Improved secondary market volume:*** Over the past five months (May – October), the average monthly loan volume settled from lenders to broker-dealers in the 7(a) secondary market has been $344 million and $322 million settled in October 2009
  - ***Recovering premiums:*** . In October, 83% of the loans settled, representing 76% of total dollars, were sold at or above premiums of 106 – a return to 2007 premium levels. By comparison, in January and February, zero loans sold at premiums above 106.

[1] This is the total gross loan value approved since February 17. Typically, due to cancellations and loan size reductions, 15 – 20% of gross approval value does not get disbursed.
[2] Includes estimate of 504 third-party first mortgages (calculated as 125% of SBA 504 debenture portion due to typical 50/40 split between third-party and SBA portion of 504 loan)
[3] Compares average weekly gross approvals in the 7 weeks prior to Recovery Act to the average weekly gross approvals since the Recovery Act was signed. Normalized for market holidays as well as disruptions caused by Washington, DC water outage (August 7, 2009).
[4] Demographic data is self-reported.
[5] See Footnote 1.

SBA
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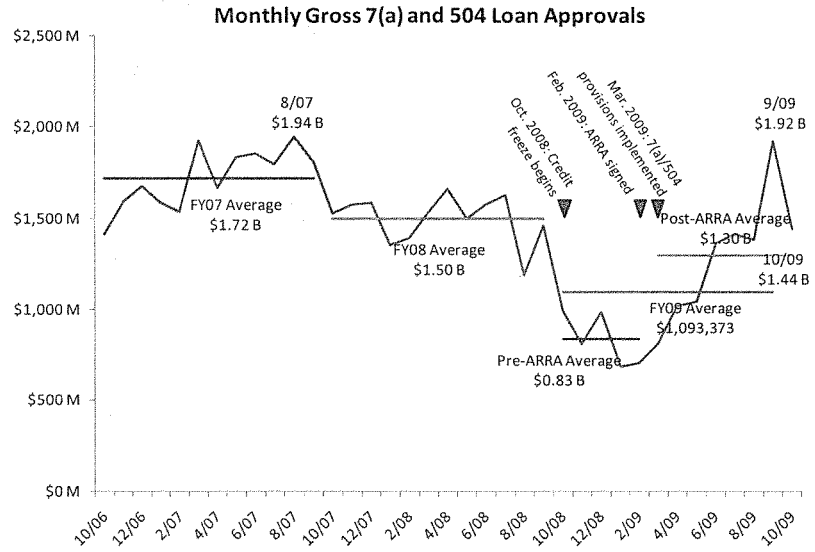
Monthly 7(a) and 504 Loan Volume: FY2007 – 2010



- October 2009's gross 7(a) and 504 approval volume was:
  - 31 percent above the monthly average for FY 2009
  - 4 percent below the monthly average for FY 2008
- Uptick partially driven by increased ongoing annual 504 borrower fees starting in October 2009 (from 0 bps to 38.9 bps)
- FY 2009 loan dollar volumes were 27% lower than FY 2008 loan volume

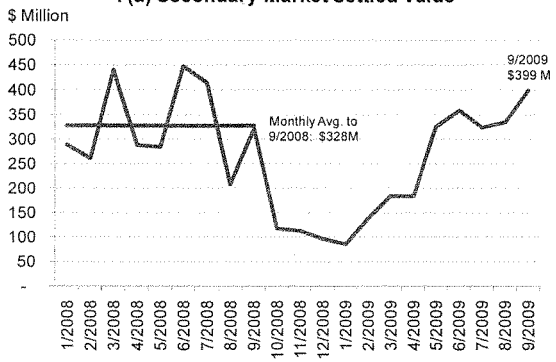
NOTE: All loan volumes are gross loan value approved. Typically, due to cancellations and loan size reductions, 15 – 20% of gross approval value does not get disbursed.

U.S. Small Business Administration

Monthly Secondary Market Metrics: September 30, 2009

Volume

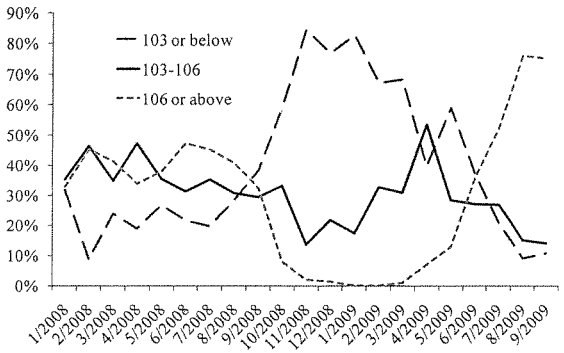
7(a) Secondary Market Settled Value



Recovery Continuing: Over the past five months, the average monthly loan volume settled from lenders to broker-dealers in the 7(a) secondary market has been $348 million, which is above pre-recession averages. In September 2009, $399 million settled in this market, the highest level since July 2008.

Pricing

7(a) Secondary Market Premium Ranges



Premiums Recovering: Premiums have begun to recover in the 7(a) secondary market, and for the past 2 months have been at 2007 levels.

Pricing Improving: In September, 82% of the loans settled, representing 75% of the total dollars, were sold at or above premiums of 106. By comparison, in January and February, zero loans sold at premiums at or above 106.

House Committee on Small Business' November 19, 2009 Hearing
Small Business Administration Response to Questions for the Record

Question #1:
The FY2010 budget for contract programs was $32 million, how much of that money is going to monitoring the SDVSB program?

Answer:
As you know, the FY2010 appropriations for the SBA have not yet been finalized. The submitted Congressional Budget request for FY2010 includes $6.562M for Government Contracting and Business Development (GCBD) programs, in addition to the non-credit program funding in the amount of $2.2M for the HUBZone program and in the amount of $3.4M for the 7(j) Technical Assistance programs. In the enacted FY2009 budget, which we are still operating from during the course of the current continuing resolution, GCBD was funded at $1.137M – excluding the non-credit technical assistance program funding. We continue to focus funding on executing and overseeing each government contracting program in the most effective and efficient manner possible.

Subsequently, the SBA would like to correct the dollar amount cited during the hearing as the contract programs' FY2010 budget request ($32 million). Once again, GCBD was funded at $1.137M in the enacted FY2009 budget. The $32M comes from the cost allocation survey of time spent by field office staff on contracting issues, not the direct appropriation level requested for the GCBD unit in budget or the enacted funding level.

Given the interconnected nature of all of the government contracting programs, it is difficult to disaggregate the exact amount spent on the SDVOSB program. In FY2009, the SBA handled 94 protests regarding SDVOSB set-asides. To date, the SBA has received 51 cases for processing for FY10. SBA Procurement Center Representatives are also working with agencies on a continuous basis in an effort to ensure that they are using the program appropriately.

Question #2:
The GAO HUBZone report features 10 companies, are those companies still able to get government contracts, are they still getting federal dollars?

Answer:
GAO Report No. GAO-08-964T specifically referenced 10 HUBZone firms for possible suspension/debarment action. Although GAO identified the 10 firms, GAO did not provide adequate supporting documentation to SBA that would justify a suspension or debarment action. In response, SBA independently investigated each of the identified firms to determine whether each firm met the HUBZone eligibility requirements at the time of award of any HUBZone contract and whether each firm currently meets those requirements. Based upon SBA's program evaluations, three firms (Advantaged Solutions, Inc., Hsu Development Co., and Logistics Systems, Inc.) were deemed eligible to continue in the HUBZone program, and the other seven firms either voluntarily left or were decertified from the HUBZone program.

SBA initiated proposed debarment actions with respect to two firms (Specialty Construction Management, Inc. and GS5, LLC). SBA's Suspension and Debarment Official (SDO) issued a show cause letter to each firm on January 8, 2009. Both firms engaged in significant dialogue with the SDO's office and submitted multiple responses regarding the actions taken by the firms. The SDO ultimately found that the two firms should not be debarred (notifying Specialty Construction Management on June 18, 2009, and GS5 on October 28, 2009) that they would not be debarred. Both firms voluntarily left the HUBZone program (Specialty Construction Management in February 2009, and GS5 in November 2008) and are currently ineligible for HUBZone awards.

Five firms (CSI Design Build f/n/a CSI Engineering, Quantum Dynamics, Inc., Platinum One Contracting, Inc., Optimization, Inc., and The CFP Group) were further investigated by the Department of Justice (DOJ). DOJ's investigation of Optimization, Inc. confirmed earlier conclusions made by SBA's SDO that, while the firm was not in compliance with HUBZone regulations at the time of the GAO audit, it was compliant at the time it bid on and was awarded its only HUBZone contract. As such, SBA's SDO determined that no suspension or proposed debarment was warranted. DOJ continues to investigate the remaining four firms in connection with civil claims against the firms. DOJ is still in the process of collecting information and conducting settlement negotiations. At the request of DOJ, SBA's SDO has not initiated suspension or debarment actions regarding any of the four firms. If DOJ is satisfied with the firm's settlement, DOJ may request that SBA agree not to take any administrative action that would prevent the firm from paying the settlement (i.e., that SBA continue not to initiate suspension or debarment proceedings).

Question #3:
What is the process the SBA has in place when a whistleblower alerts the agency to a fraudulent company in a contracting program? Does the SBA suspend that companies ability to get federal contracts?

Answer:
The SBA is in a continual process of strengthening the oversight of all of its programs. While the SBA currently does not have a specific "whistleblower" policy per se about alerting Agency of possible fraudulent conduct in small business contracting programs, many safeguards already exist. The SBA's Office of Inspector General has a telephone tip line and an email tip line for reporting fraud. SBA is actively reviewing current procedures while exploring new ways to ensure OIG receives all allegations of contracting fraud. Moreover, whenever SBA receives credible information from any source that a small business concern (SBC), a HUBZone SBC, an 8(a) SBC, or a Service Disabled Veteran-Owned (SDVO) SBC is not eligible or has misrepresented its status, SBA will review the firm's continued eligibility or status, as appropriate. In this regard, SBA's 8(a) Business Development (BD) program regulations specifically authorize SBA to conduct an investigation into a firm's continued 8(a) BD program eligibility "[u]pon receipt of specific and credible information alleging that a Participant no longer meets the eligibility requirements for continued program eligibility." 13 C.F.R. § 124.112(c). While the HUBZone regulations are not as specific as the 8(a) BD regulations on this point, they do have the same effect. Specifically, the HUBZone regulations state that "SBA

may conduct a program examination . . . at any time while the concern is certified as a qualified HUBZone SBC," 13 C.F.R. § 126.402, and where credible evidence is presented to SBA that a firm no longer qualifies as a HUBZone SBC, SBA will conduct a formal program examination of the firm. SBA may also seek a formal size determination with respect to a firm in connection with an SBA program or protest the size of a firm at any time (before or after award) with respect to a contract for which the firm certified itself to be small. *See* 13 C.F.R. §§ 121.1001(a), 121.1001(b), 121.1005(b). Again, SBA would initiate a formal size determination or size protest where it receives credible and specific information that a firm misrepresented its status as a small business or otherwise does not qualify as small. Similarly, SBA may file a protest challenging the SDVO status of a firm claiming to be a SDVO SBC at any time. 13 C.F.R. § 125.25(d)(3). SBA has, in fact, used this authority to protest the SDVO status of a firm even after a SDVO contract expired when it received credible information questioning the SDVO status of the firm.

SBA's 8(a) BD regulations specifically authorize SBA to suspend a firm from receiving further 8(a) BD program benefits when necessary to protect the Government's interests pending the outcome of proceedings to terminate the firm from the 8(a) BD program. *See* 13 C.F.R. § 124.305. A suspension or termination from the 8(a) BD program would prohibit the firm from receiving further 8(a) BD assistance, but would not prevent the firm from receiving other Government contracts. SBA may initiate Government-wide suspension or debarment where a firm has misrepresented its status as a SBC, HUBZone SBC, SBC owned and controlled by socially and economically disadvantaged individuals (including 8(a)), a SDVO SBC, or a woman-owned SBC. *See* 15 U.S.C. § 645(d). SBA has initiated Government-wide debarment actions where firms have so misrepresented their status.

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