AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

SUBCOMMITTEE ON CONTRACTING AND TECHNOLOGY FIELD HEARING IN NORFOLK, VA ON VETERAN CONTRACTING: PREVENTING FRAUD

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES
HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

HEARING HELD
MAY 24, 2010

Small Business Committee Document Number 111-069
Available via the GPO Website: http://www.access.gpo.gov/congress/house

U.S. GOVERNMENT PRINTING OFFICE

56–299 PDF WASHINGTON : 2010

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

HOUSE COMMITTEE ON SMALL BUSINESS

NYDIA M. VELÁZQUEZ, New York, *Chairwoman*
DENNIS MOORE, Kansas
HEATH SHULER, North Carolina
KATHY DAHLKEMPER, Pennsylvania
KURT SCHRADER, Oregon
ANN KIRKPATRICK, Arizona
GLENN NYE, Virginia
MICHAEL MICHAUD, Maine
MELISSA BEAN, Illinois
DAN LIPINSKI, Illinois
JASON ALTMIRE, Pennsylvania
YVETTE CLARKE, New York
BRAD ELLSWORTH, Indiana
JOE SESTAK, Pennsylvania
BOBBY BRIGHT, Alabama
DEBORAH HALVORSON, Illinois
SAM GRAVES, Missouri, *Ranking Member*
ROSCOE G. BARTLETT, Maryland
W. TODD AKIN, Missouri
STEVE KING, Iowa
LYNN A. WESTMORELAND, Georgia
LOUIE GOHMERT, Texas
MARY FALLIN, Oklahoma
VERN BUCHANAN, Florida
BLAINE LUETKEMEYER, Missouri
AARON SCHOCK, Illinois
GLENN THOMPSON, Pennsylvania
MIKE COFFMAN, Colorado

MICHAEL DAY, *Majority Staff Director*
ADAM MINEHARDT, *Deputy Staff Director*
TIM SLATTERY, *Chief Counsel*
KAREN HAAS, *Minority Staff Director*

SUBCOMMITTEE ON CONTRACTING AND TECHNOLOGY

GLENN NYE, Virginia, *Chairman*

YVETTE CLARKE, New York
BRAD ELLSWORTH, Indiana
KURT SCHRADER, Oregon
DEBORAH HALVORSON, Illinois
MELISSA BEAN, Illinois
JOE SESTAK, Pennsylvania

AARON SCHOCK, Illinois, *Ranking*
ROSCOE BARTLETT, Maryland
TODD AKIN, Missouri
MARY FALLIN, Oklahoma
GLENN THOMPSON, Pennsylvania

CONTENTS

OPENING STATEMENTS

	Page
Nye, Hon. Glenn	1

WITNESSES

Kutz, Mr. Gregory, Managing Director, Forensics Audits and special Investigations, U.S. Government Accountability Office	4
Cavolt, Ms. Janice., Owner, JBC Corp, Virginia Beach, Virginia, On behalf of The American Legion	6
Walters, Ms. Cindy M., Director, Hampton Roads Procurement Assistance Center, Old Dominion University Business Gateway, Norfolk, VA	8
Roller, Mr. Elton, Greenland Enterprises, Inc., Hampton, VA	10
Armbruster, Mr. George, Co-Owner, Fleet Services and Installation, LLC, Portsmouth, VA	12

APPENDIX

Prepared Statements:

Kutz, Mr. Gregory, Managing Director, Forensics Audits and special Investigations, U.S. Government Accountability Office	31
Cavolt, Ms. Janice., Owner, JBC Corp, Virginia Beach, Virginia, On behalf of The American Legion	46
Walters, Ms. Cindy M., Director, Hampton Roads Procurement Assistance Center, Old Dominion University Business Gateway, Norfolk, VA	49
Roller, Mr. Elton, Greenland Enterprises, Inc., Hampton, VA	52
Armbruster, Mr. George, Co-Owner, Fleet Services and Installation, LLC, Portsmouth, VA	54

SUBCOMMITTEE ON CONTRACTING AND TECHNOLOGY FIELD HEARING IN NORFOLK, VA ON VETERAN CONTRACTING: PREVENTING FRAUD

Monday, May 24, 2010

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

The Subcommittee met, pursuant to call, at 9:30 a.m., at Ted Constant Convocation Center, 4320 Hampton Boulevard, Norfolk, Virginia, Hon. Glenn Nye [chairman of the Subcommittee] presiding.

Present: Representative Nye.

Chairman NYE. I will now call this hearing to order. First of all, thank you all for joining us this morning. I appreciate you making your time available to us to talk about this important issue and sharing your insights and thoughts with us.

This is a field hearing of the House Small Business Committee Subcommittee on Contracting and Technology. I want to make a special thanks to the Small Business Committee staff also for traveling to be with us today to address this important issue, protecting service-disabled veteran business owners from fraud.

First and foremost, I view my role as Chairman of the Contracting Subcommittee as one that supports the economic security of our returning service members. As more of our men and women return home from conflicts in Iraq and Afghanistan Congress must adopt policies that offer them a chance to succeed as business owners. As we do so there is no better place to look for guidance than right here on Hampton Roads.

I have the honor to represent Virginia's 2nd District which is home to the largest concentration of veterans, military personnel, and military families anywhere in the country. In fact, more than 100,000 veterans reside here in Hampton Roads. We know firsthand that out community is stronger because of the service of our military personnel and the contributions of our veteran community.

The same drive and dedication that leads brave men and women from Hampton Roads to serve our country in uniform also leads many of them to take on the challenges of entrepreneurship. Like small businesses all across the country veteran-owned small businesses are a crucial part of our economy helping to create jobs and spur economic development. It is no secret why they are successful.

Their skills and training that our veterans learn in the military are incredibly valuable in the private sector.

However, even our most successful entrepreneurs are hindered from success when fraud and abuse prohibit their businesses from contracting with the world's largest consumer, the U.S. government.

The government buys everything from paper clips to computer systems so if a small firm sells it, the government likely buys it. For many entrepreneurs working with the federal government as a prime or a subcontractor has been a valuable business experience and has helped them launch countless successful ventures.

In fact, while much of the economy struggled over the past year the federal market place grew by nine percent. Last fiscal year alone $3 billion in federal contracts flowed to our region and $93 million of that went to service-disabled veteran-owned businesses last year.

It is more important than ever that veteran-owned businesses are able to access this expanding market place. Veteran-owned businesses are particularly well equipped to compete for these contracts. Having spent time in the military these business owners are often acquainted with the procurement process. Sometimes they have specialized skill sets that serve particular government needs. Veteran security clearances make them candidates for defense-related work and other sensitive projects. For all these reasons I have made veteran small business issues a priority.

Earlier this year the House of Representatives passed legislation I authored, the Veterans Business Center Act, which will offer enhanced training and technical assistance to veterans interested in launching new businesses. Despite their valuable experiences in the military, many veterans retire without the resources to translate their skills to the challenges of starting and running a business.

The creation of a nationwide network of veteran business centers will provide counseling and business training, assist veterans in accessing capital and securing loans and credit, and will help veterans navigate the procurement process to compete more effectively in the federal market place.

But removing barriers and creating opportunities for veterans only works when these programs are run properly. Our outdated and under-resourced contracting policies have led to a great amount of fraud and outright abuse of this system.

As many of you are aware, this past November the GAO uncovered nearly $100 million of fraud in the SDVOSB contracting program. It is disgraceful that unscrupulous businesses have been allowed to profit from taxpayer dollars intended for our veteran business owners.

The GAO identified cases of large multi-national companies gaming the system to cheat veteran-owned businesses out of federal contracts. In other instances firms subcontracted all of their work out to large companies that are not veteran-owned and do not have veteran employees. I believe two problems have led us to this situation.

One, there has been limited to no accountability in the system. The GAO report revealed that if someone had taken the time to look into these contracts, it would have been quickly realized these contracts were fraudulent. Two, there is no recourse and no pen-

alties in place to disincentivize these abuses. If red flags are waived or complaints are filed, there are no consequences. The contracts and money remain in the hands of the fraudulent business owners. We need better policing in the contracting system.

Rightly so Congress created a set-aside program to repay veterans by providing them an avenue to gain economic security when they return home from the battlefield. The businesses responsible for defrauding the Service-Disabled Veteran Contracting Program are not only defrauding the U.S. Government and the taxpayer. They are defrauding our veterans. They are profiting at the expense of those who are willing to sacrifice everything for our country's prosperity.

If we are truly sincere about our commitment to our veterans, then the Service-Disabled Veteran Contracting Program must be more than an empty promise. The goals must be clear. The rules must be enforced and there must be consequences for those who would defraud our nation's veterans.

I am committed to the goal of eradicating fraud in the federal contracting system and I have taken the first steps to fix this problem. I recently introduced the Service-Disabled Veteran-Owned Small Business Procurement Reform Act. This act will finally put in place punitive consequences for those who attempt to circumvent the law at the expense of our veterans.I intend to continue to put strong measures in place to ensure that the agencies which contract to veteran businesses are held accountable and that all federal veteran business programs are properly resources.

There is another reason why this is important. In light of the fraud recently uncovered in the Service-Disabled Veteran Program it is difficult to talk about contracting goals being met because the data may be flawed. Even when disregarding the existence of fraud and abuse in the system the federal agencies have not had a favorable history of meeting their contracting goals. Agencies' perpetual struggle to meet their contracting goals often results in shortfalls as experienced in the Service-Disabled Veterans Small Business Program.

In 2008 service-disabled veteran businesses received only 1.5 percent of government contracts when they are required to receive at least 3 percent. Moreover, the total number of veteran owned businesses only received 3.2 percent of government contracts. Add to these dismal numbers the GAO report on fraud and the Service-Disabled Veteran Small Business Program it is clear that we must focus our efforts to fix unnecessary barriers in the contracting process.

In the coming weeks the Small Business Committee will be developing legislation to overall all of the SBA's federal contracting initiatives. The Contracting and Technology Subcommittee will take the lead in formulating that legislation and I intend to ensure veteran's needs are considered throughout that process.

Ultimately honoring our commitment to our veterans takes more than just saying the right words or even passing the right laws. It requires enforcing those laws and ensuring real accountability. That is what this hearing is about and that is my commitment to our returning service members as they make the transition from

defending our national security abroad to building our nation's economy here at home.

Now I would like to turn to our witnesses and hear their testimony today. We are going to be operating on the five-minute clock. You will see some lights in front of you on the table. It will start out green, it will turn yellow when there is a minute left, and then it will turn red when your time is up. We can be a little bit lenient with the time so if you have a few more things to say and it turns red, don't panic. I will give you a little bit of extra time if you need it so don't worry too much about that. We just want to make sure everybody has an opportunity to be heard.

I am going to start by introducing our first witness, Mr. Kutz, the Managing Director of Forensics Audits & Special Investigations at the GAO. The FSI unit investigates waste, fraud, and abuse related to government programs. The FSI has investigated abuses of Hurricane Katrina relief dollars, border security, and federal contracting programs. Mr. Kutz testified before the full Small Business Committee recently and has some updates to share with us today.

Mr. Kutz, thank you for joining us.

STATEMENT OF GREGORY KUTZ

Mr. KUTZ. Mr. Chairman, thank you for the opportunity to discuss the Service-Disabled Veteran-Owned Small Business Program. Today's testimony highlights the key elements necessary to prevent fraud and abuse in this important program.

As you mentioned, last November I testified before the full Committee on details related to 10 firms responsible for $100 million of fraud and abuse in this program. According to small business owners fraud and abuse in this program has been wide spread since its inception. This should not be a surprise. Multi-billion dollar self-certification programs serve as an invitation to fraudsters across the country to take advantage of our government.

Let me start by saying that there is no system of controls that can eliminate fraud and abuse in any program. However, the monitor, and in your packet, Mr. Chairman, shows the three key elements necessary for an effective fraud prevention program. I will discuss these elements from left to right starting with prevention.

Our work across the government has shown that prevention is the most efficient and effective way to minimize fraud and abuse. For this program prevention means an effective certification process to validate the eligibility of firms before they enter the program. Key components of this include ensuring that owners are, in fact, service-disabled veterans verifying self-reported contractor data against third-party sources and determining who is controlling and operating the firm.

One method that we use that SBA and VA should consider is the unannounced site visit. These surprise visits can reveal things such as shell companies or who is actually controlling and operating the firm on a daily basis. Further, a properly managed and staff certification program should not result in a large backlog of legitimate firms waiting to be certified.

Please refer back to the monitor and your slide to the second element, detection and monitoring. Here the focus should be on risk-based reviews. This should include looking at firms that have re-

ceived sole source and set-aside contracts. One key indicator of fraud is firms with a small number of employees and a large number of contracts.

Firms are required to perform 15 to 50 percent of the work with their own employees. However, one of the firms that we investigated had only five employees, yet they received 33 service-disabled contracts across the country for over $7 million.

Back to the monitor and the final element of an effective program is consequences for those that commit fraud and abuse in the program. We are encouraged that there has been activity related to the 10 cases that we investigated and I testified on last November.

However, history shows that it is unlikely that anyone will be prosecuted for this fraud. Why? Because U.S. attorneys and agencies believe that there is no loss to the government. I happen to disagree with this view. I believe that when a fraudulent firm receives a contract that the entire amount of that contract is fraud. This fraud also robs legitimate firms not only of the opportunity to do the business but also the chance to hire veterans.

Will anybody be suspended or debarred? Will anybody have their contract taken away that they received through fraudulent schemes? History shows this is highly unlikely. Until the government gets serious about making some poster children of those that commitment fraud and abuse in this program, then widespread fraud will continue.

In conclusion, Mr. Chairman, we continue to receive numerous allegations of fraud and abuse in this program. We owe it to legitimate service-disabled veteran entrepreneurs to make sure that they get the benefits of this important program. I look forward to working with you and this Subcommittee, VA, SBA, and veterans across the country to bring integrity to this important program.

I applaud you today, Mr. Chairman, for your support for veterans. That ends my statement and I look forward to your questions.

Chairman NYE. Thank you very much and I appreciate your work in uncovering this fraud and the follow-up that you've done and being with us here today. I look forward to in the question and answer session talking to you in a little bit more detail about your recommendations for how we can move forward to solve this problem so I appreciate you being here.

Mr. KUTZ. Thank you.

Chairman NYE. I would now like to introduce Ms. Janice Cavolt. Ms. Janice Cavolt is a minority owner of JBC Corp. in Virginia Beach. She established the business together with her husband Brian who is a service-disabled veteran.

JBC Corp. provides customized medical trauma kits to members of the military and others. Ms. Cavolt is testifying on behalf of The American Legion as well, the nation's largest veteran service organization.

Thank you for being with us.

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

STATEMENT OF JANICE CAVOLT

Ms. CAVOLT. Thank you, Chairman Nye. I do appreciate the opportunity to be here. I am here today as a member of the National Small Business Task Force of the American Legion. It is an honor to be here under their cover. As everybody knows, the American Legion is the loudest voice a veteran can have on their side. If you do not belong, I urge you to do that now. Join. Thank you again.

I am grateful for this opportunity to express my opinion on preventing veteran contracting fraud and I'm thankful that the government has taken notice and is proposing action to remedy the issues that impede the success and growth of service-disabled veteran-owned businesses.

I am the wife of a 100 percent rated service-disabled veteran. My husband Brian Cavolt served as a Navy Seal and Corpsman and retired after 29 years active duty service. Together we own and operate JBC Corp., a service-disabled veteran-owned small business located in Virginia Beach, Virginia. JBC Corp. provides customized medical kits for members of the military which are carried and used in all parts of the world.

The findings by the GAO investigation of November 2009 were discouraging. However, it did not come as a complete surprise to many veteran business owners. The tremendous competition for few opportunities cause SDVOSBs to work in the trenches where we have a peripheral view of what goes on in federal procurement. Awards to eligible firms who are not even having the opportunity to bid is one part of the problem. The other is the government's blind eye that doesn't see how poorly the contracting system is working and the need for an overall.

In my opinion, the federal contracting system as it operates now is wasteful, inefficient, and rewards big business at the expense of small business, the taxpayer, and the government. It is a system riddled with rules and procedures to keep SDVOSBs and other small businesses from competing for awards often for their own products or within their field of expertise.

Perhaps the dynamic that is most difficult to comprehend is that currently misrepresenting yourself when doing business with the government carries no penalty. In fact, under the federal acquisition regulations a contracting officer may allow continuation of performance if a valid contract still exist. In other words, obtaining an award under false pretenses does not invalidate the contract. It is encouraging to know that Congressman Nye is taking action to introduce legislation to address this issue and criminalize the behavior.

During recent testimony to the Veteran's Affairs Subcommittee on Economic Opportunity Joseph Sharpe from the American Legion offered the Legion's opinion whereby the VA and SBA should develop a comprehensive partnership to assist veterans who are interested in participating in federal procurement with each department utilizing their resources to ensure proper implementation.

Mr. Sharpe points out that the Center for Veteran Enterprise, a program of the VA, currently maintains the veteran information pages database. The VIP database has established itself as a premier database for veterans in the country and is the only federal database focusing strictly on veteran businesses.

Under this recommendation the VA, or the CVE, should maintain the database and verify accurate veteran and service-disabled veteran status and the SBA should retain the responsibility for validating the business ownership, size, standards, and structural integrity of the business.

Mr. Sharpe's statement is referenced here and I urge everyone in this room to read his statement in its entirety.

I believe the ability of these two agencies to share accurate information that is accessible for verification would be the greatest step in addressing the problem of fraudulent representation. However, I believe that we must go a step further by instituting enforcement at the procurement level.

Contracting officers should be required to verify the status and eligibility of every bidder on any set-aside solicitation. Proposals from those who do not qualify should be immediately removed from consideration. Misrepresentation should be reported to the SBA so that appropriate remedial action is taken.

In summary, I believe the approach to the problem needs to be two-fold. First, verification and validation in accordance with the guidelines recommended by American Legion and, second, there must be enforcement at the point of entry; that is, the submission of the bid.

It is important to recognize the two separate parts of this problem. To not segregate the two processes would be like asking the U.S. Department of State to be accountable for someone who is using a fake passport as identification to get through security at the airport. The burden should be on the party granting access, not the agency granting legal passports.

In conclusion, the need to protect business opportunities for SDVOSBs is critical to ensure the success and growth of their businesses. Although establishing a check and balance system will cause an extra step to be taken by SDVOSBs it is the only way that set-aside solicitations can be protected.

However, having said that, caution must be exercised when implementing the solution. It is important that the process is adapted to protect the service-disabled veteran contracting opportunities do not become obstacles that get in the way of veterans doing business. Instead, let us make it difficult for ineligible businesses to compete. Remember, the veterans who go through a process of validation are not the ones breaking the rules.

Thank you very much. I appreciate this opportunity.

Chairman NYE. Thank you for your testimony.

I would now like to introduce Cindy Walters, the Director of the Hampton Roads Procurement Assistance Center at Old Dominion University Business Gateway. The center assist local businesses in establishing themselves to bid competitively on federal, state, and local government contracts.

Ms. Walters, thank you for being here. We understand how challenging sometimes navigating the procurement system can be so we know how valuable your advice is to our local business community. I appreciate you taking the time to be with us and we are looking forward to hearing your testimony.

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

STATEMENT OF CINDY M. WALTERS

Ms. WALTERS. First, let me thank you, Congressman Nye, and the Committee for doing these investigations, having these hearings and doing things to assist our service-disabled veteran and veteran-owned small business community. We very much appreciate that.

What the GAO report uncovered most importantly in its findings was the unacceptable and criminal behavior of those who would opportunistically take advantage of service-disabled veterans and programs legislated specifically to assist them in achieving procurement opportunities with the federal government and also in defrauding the taxpayer.

As long as there are procurement set-aside programs whether they be small business, minority, 8(a), veteran, SDVOSB, HubZone, or woman-owned business programs with money to be gained, there will always be those who are determined to game the system.

Even in the most heavily certified and managed business development procurement program, the SBA 8(a) program, there are still cases of fraud. We should continue to brace ourselves for interest by criminally minded persons and creating companies to gather money to them as each federal agency tries to increase its goals by billions of dollars to turn those red blocks to green blocks on the score card.

I've been associated with these programs for the majority of my career in some form assisting businesses and the government to create compliant, successful, federal contracting industry partners. I work directly on an almost daily basis with veteran and service-disabled veteran-owned small business owners.

Their questions about government procurement, and specifically their ability to access acquisitions set aside for them are many and varied and illustrate some of the complexities that when misused by non-veterans and those unscrupulous people make the veteran and service-disabled veteran-owned small business very vulnerable.

Eligibility issues come up frequently such as the following. "I have a service connected disability but have no letter from the VA." "I have a letter from the VA but do not own the majority of my company." "I have another company who has the capital or past performance to help me to compete. Can I team with them or do a joint venture?"

These are the scenarios in which a veteran can become caught up unintentionally in what may turn out to be a fraudulently executed or awarded federal contract. In these instances the veteran may also be the victim as well as the government. Then, on the other hand, we have the issue where no veteran was involved and the entirety of the process was set up to defraud.

I am not a proponent of another large scale certification process management and policing program to add to the very full basket of SBA. I do, however, suggest that we could have a positive impact on the set-aside program for our veterans by perhaps implementing some of these changes I'm going to suggest either legislatively or culturally.

First, those persons and firms who are not veterans and fraudulently claim to be so when preparing their certifications and reps for federal contracting when found to be doing so by any notifica-

tion or source should be debarred and criminally prosecuted. Most likely these persons have intentionally gained several other government programs such as those set aside for women, minorities, and may also be preying on veteran-owned businesses as well at the time.

These persons and firms may not be new to federal contracting and may have in many cases fraudulently worked the system for years. For those firms where persons that certify themselves as service-disabled veteran-owned small businesses but, in fact, are just veterans, they may be referred to the appropriate agency like the Center for Veteran's Enterprise for training, counseling investigation.

In those instances we don't want to take veterans who may have made a mistake and criminalize them.

Secondly, and most important, is the federal contracting work force should always use its authority to request a pre-award survey be conducted for each service-disabled veteran-owned small business set-aside award. Currently a federal acquisition regulation, FAR Part 19.1403 the only requirement is that each of the service-disabled veteran-owned small businesses certify themselves through the certs and reps to be such. We should require, and I believe it would be where the rubber meets the road, if the contracting officer would utilize their authority to request a pre-award survey.

In this process they should use DCAA and DCMA as needed to conduct reviews of control and management documentation. That includes eligibility letters, organizing documents, stock ledgers, etc., to ensure before the award is made that the firm is owned and controlled by that member.

Thirdly, recognize and respect the skills that the veteran business community has in terms of policing their own. Quite often times the service-disabled veteran-owned small business community will know if another company has reached out or is proposing on a contract and know that they are not veteran-owned or service-disabled veteran-owned.

If we simply have a way like a form up on the SBA site where a veteran can go and report what they believe that they are seeing happening, or a resource partner like the PTAC or the SBDC can go and report that, then we have a database or a place where we are listening to our veteran community and letting them and recognizing their skill and policing their own.

And then fourth, and last but not least, we need to continue to utilize our network of federal and federally funded resources to include the acquisition workforce to continue to educate the veteran community on the program, the nuances of the program and the requirements of the program.

As we bring more and more visibility to these programs by these types of hearings and by educating the community, the more visibility the less cases of fraud that I believe we will have. We can't eradicate fraud but we can reduce the amount of instances.

In my conclusion, thank you again for having these hearings and thank you for allowing me to testify.

Chairman NYE. I appreciate you being with us and look forward to following up on some more detail with you after we hear all the testimony.

I would now like to introduce Mr. Elton Roller of Greenland Enterprises, Inc. based in Hampton, Virginia. Mr. Roller is a decorated veteran who served in the U.S. Air Force for nearly 10 years. In 2008 he founded Greenland Enterprises which specializes in design-built mechanical and general construction projects.

Mr. Roller, thanks again for your time this morning and we are looking forward to hearing your testimony.

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

STATEMENT OF ELTON ROLLER

Mr. ROLLER. Thank you, Chairman Nye. Chairman Nye and distinguished members of this Committee, it is an honor to speak on behalf of veteran business owners about ways we can work together to strengthen the SDVOSB procurement program and ways of preventing fraud.

As a small business owner and nine-year veteran of the U.S. Air Force I am proud that our federal government has found ways to keep veterans serving through entrepreneurial opportunities. It is no secret that veteran business owners share a fierce allegiance to fellow veterans and often extend employment opportunities ahead of their needs.

In some cases positions are created and extended to candidates requiring significant investments and training and time. Veteran business owners view this as an inherent duty to those who have served. Simply said, veterans hire veterans.

Procurement strategies like the SDVOSB set-asides effectively ensure that veteran entrepreneurs continue this culture of offering opportunities, hiring, training, and growing the next group of veteran business owners. Recently tough economic times and the promise of winning government contracts has taken those opportunities from veterans and placed them in the hands of fraudulent businesses.

As most of you know, a recent GAO report sampled 10 SDVOSBs and found all 10 lacking the requirements to be eligible to participate in the program. This ignorance of the law and worse-case example of fraudulent activity can only be attributed to several factors including the lack of private sector opportunity, oversight of the program by any one agency and, most importantly, an absence of significant financial or criminal penalties.

A little bit of background. After serving my country and working for two large HVAC manufacturers my entrepreneurial passion could only be satisfied by going out on my own. With the unwavering support of my family my partner and I established Greenland Enterprises in February of 2008. Our business became a CVE, Center for Veteran Enterprises, verified SDVOSB in July of 2008.

From the onset we knew that any business venture comes with inherent risk but coupled with the worst economic decline since the great depression, an uncertain economic future, dwindling equity and personal assets, and a banking industry on hold we were specially anxious.

Fortunately for us luck, prayers, and experience prevailed as we were awarded several private projects in our first federal SDVOSB set-aside contract at the Richmond VA Medical Center in September of 2008.

Some of the challenges we've experienced since then: From those anxious moments in 2008 Greenland Enterprises has experienced steady growth fueled primarily through federal procurements under the SDVOSB program. These opportunities have allowed us to establish deep roots in the local and regional market place. They have also allowed us to hire veterans both as employees and subcontractors and they have enabled us to give back to the veteran community.

The same SDVOSB program that allows a well-managed small disabled veteran owned business with good core values to become a success story also serves as a haven for fraudulent businesses with poor decision making. We experienced this first hand in 2009 when a number of commercial contracting firms flooded the SDVOSB program with shell companies masquerading as small SDVO owned and controlled businesses.

In our particular instance evidence presented to a contracting officer at the time of award clearly established affiliation between the awarded SDV and a large business both having common ownership.

Our complaint was summarily dismissed by the contracting officer and we were referred to the area SBA representative for determination of the alleged offender. The SBA agreed with our position but referred the matter back to the awarding contracting officer.

We were advised that we had an opportunity to protest the award and ultimately take on a large business to prove what was already established is a clear and blatant affiliation between parties. With consideration of our financial position, uncertainty in getting the award and the backlash that might ensue we reluctantly declined.

After observing other awards made to the same contractor on other SDV set-asides I took up the matter with the GAO and they referred me to the Inspector General's Office of the departmental agency. To date I have not received an update on my complaint but did find satisfaction that the Director of Government Contracting with the SBA on their own accord found that same contractor to be other than small in a protest on an unrelated award.

Justice was eventually served but many verified SDVs were denied opportunity through the action of this fraudulent company. With the lack of opportunity in the private sector more firms will continue to migrate to the federal sector and with that the potential for fraud will increase. Until the price for noncompliance outweighs the price of compliance, the SBA, the GAO, and lawmakers will continue to hear examples like this.

We believe the tool to prevent such actions has already been established with the Center for Veteran Enterprises verification process and that the timeline for implementation, currently 2011, is not soon enough. With the verification process in place contracting officers can quickly confirm the legitimacy of SDV firms thus making the process of awards more efficient.

Protest of such awards will be reduced and the stigma of the GAO report and fraud in the SDV program will diminish.

Chairman, thank you for the opportunity to share the experiences of Greenland Enterprises. I would like to personally thank you and this Committee for your commitment to veterans and small business. I would also like to take the opportunity to remind your colleagues in Congress that small business is the lifeline of this country and capitalism. We must continue to foster opportunities, have an open dialogue such as this with law makers, and take the necessary action to put veterans and Americans back to work. Thank you for your time and dedicated service to our country.

Chairman NYE. Thank you, Mr. Roller, and I appreciate your comments and appreciate you sharing your personal business story with us today.

I would now like to introduce Mr. George Armbruster and Mr. Duke Ingraham, our final witnesses, co-owners of Fleet Services and Installation, LLC based in Portsmouth, Virginia. Mr. Ingraham graduated from the U.S. Naval Academy and is a disabled veteran who served the U.S. Navy for five years. The company specializes in the procurement and the installation of building materials.

Mr. Armbruster graduated from the Virginia Military Institute. Both started the firm in 2008.

I'll recognize you each in the order that you're sitting here but I recognize you may have individual comments to make. We'll start with Mr. Ingraham if you would like.

Mr. INGRAHAM. He's going to start.

Chairman NYE. Okay. Mr. Armbruster will start.

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

STATEMENT OF GEORGE ARMBRUSTER

Mr. ARMBRUSTER.Congressman Nye, thank you for allowing me to speak on behalf of owners and members of service-disabled veteran-owned small businesses throughout the United States. This testimony will describe to the Committee the challenges service-disabled veteran-owned small businesses are facing due to the lack of an enforceable plan and accountability for the Executive Order 13360.

We started Fleet Imports in 2008 and in 2009 we started bidding work as a subcontractor to large general contractors working on federal construction projects. We bid over 100 projects to larger GCs but to this date we have only received three subcontracts. We know that Executive Order 13360 a 3 percent goal is in place for prime contracts and subcontracts for all SDVOSBs.

The whole process begins when a large construction project is solicited. Very large general contractors are interested in pursuing a project. They develop a small business plan that they feel will win favor of the contracting officer. These large businesses reach out to the small business community through Small Business Outreach fairs and take our information.

Next these general contractors ask us for a price on certain scopes of work. They submit their proposals to the contracting officers. During the evaluation period a contracting officer looks over

the proposal and also checks to see if a proper small business plan was developed and a general contractor is then selected.

At this point the general contractor finishes up their design drawings, the final step in buying out scopes of work or subcontracting is the next phase. This is where the problems occur. The general contractor will look for the absolute lowest price when buying out scopes with little to no regard to SDVOSBs.

Once the project is completed the general contractor will have to explain to the contracting officer why they did not meet their goals. Time and time again they tell contracting officers that they gave it their best effort to find SDVOSBs to participate. All these practices are allowed because there is no oversight, no accountability, no penalties, and no program.

We have found that if our price is not the absolute lowest bid we will not receive a subcontract to work on government projects. For example, last year we bid on a ceramic tile subcontract for a large federal hospital near Washington, D.C. We were recommended by the GC to the Army Corps of Engineers. The Army Corps of Engineers decided that our price was not the absolute lowest for the ceramic tile and gave the contract to the lowest bidder. We later found out that our subcontract price was only 1 percent higher than the lowest bidder, a large business.

The SDVOSB set-aside appears to be totally irrelevant to contracting officers and larger general contractors working on federal construction projects. This is because there is absolutely no oversight or accountability. As the system stands now the SDVOSB set-aside program in relation to subcontracting is an honor program which very few honor.

Another frustrating experience was when we tried to work for general contractors on foreign embassies for the U.S. State Department overseas building operations. We traveled out to Alabama to meet with the two largest general contractors priming the largest percentage of the foreign embassy projects. We were interested in natural stone cladding scopes of work on these projects.

We were told by these GCs that they purchased natural stone materials from overseas suppliers and that they used overseas labor for installation of cladding. They follow these practices because of low foreign labor costs as compared to using qualified United States labor. Companies here in the U.S. have to follow the Davis Bacon Wage Scale on projects here in the United States. They don't have to follow these same labor rules while working on foreign embassies.

One of the general contractors working on a foreign embassy project told me that we would have to significantly beat their current supplier and labor cost to gain their business. After the meeting I spoke with the U.S. State Department over seas building operations representative and asked if they were required to meet any SDVOSB goals. The representative informed me that since the projects were overseas, general contractors have no goal requirements for using SDVOSBs as subcontractors.

This is maddening when you consider that we have 25 percent unemployment in the United States construction field. Tax dollars are being used on these projects without SDVOSB participation.

Foreigners are being used to install natural stone building cladding on United States embassies.

Senator John Kerry introduced legislation to advance U.S. embassies and consulate design on April 16, 2010. Senator Kerry's legislation stated, "The legislation recognizes United States embassies are an important reflection of American values of openness, ingenuity, innovation and should reflect the best of the U.S. design, architecture, sustainability and technology while maintaining security as a top priority. Why are we denying our veteran-owned small business the opportunity to participate in the construction and security of our embassies?"

To combat the multitude of problems described herein other service-disabled veteran firms that have been in the commercial business for several years have advised us to give up bidding on subcontracts. They claim we should focus on priming jobs directly to the federal government.

Our problem with this advice is that we are emerging into the commercial market with valuable experience but still need to hone our skills, build a financial base and develop bonding capacity prior to taking on a prime contract. There are many veterans and service-disabled veterans that will be entering the job market in the near future. If any of these individuals decides to pursue a career as a entrepreneur in the construction field, they will need to gain financial backing, bonding, and experience before priming a federal job on their own.

Subcontracting to larger general contractors on federal projects will give these veteran business owners opportunities to develop into prime contractors. Oversight and accountability is critical in any program. Congress needs to end the facade and support service-disabled veteran-owned entrepreneurs growing small businesses. Congress needs to require all SDVOSB firms to become certified through a program instead of self-certification to avoid fraud.

Congress needs to require general contractors working on federal construction projects to provide the names of qualified SDVOSBs that they will be using up front. The responsible contracting officer should ensure that stated goals will be met before awarding any contract. Additionally, substantial penalties should be given on all awarded contracts for companies that do not meet these required goals.

Congressman Nye, we greatly appreciate what you are doing for service-disabled veteran-owned business owners and members of these companies.

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

Chairman NYE. Thank you for your testimony. Actually, if you don't mind, I'm going to start with you, Mr. Armbruster on the questions because you've raised some interesting topics and I wanted to follow up immediately with you on a couple of these things.

It's very clear to me that this is a multi-level problem that goes from the point of application or certification all the way through the contracting process with various issues with the contracting process. There is the fraud element which we've got to route out and attack. There is also just the question of how contracting officers are approaching these contracts.

What I wanted to ask you was specifically about your question about overseas contracting. Can you talk us through a little bit? There are some suggestions, I think, we hear that smaller firms just aren't able to produce the work and get involved in the overseas contracting. Can you help us dispel some of the mythology there and just talk us through what the capabilities are for small firms who do that kind of work?

Mr. ARMBRUSTER. Sure. Two years ago when we formed the company, Duke and I, we import granite and marble and from overseas currently. We approached the two largest general contractors in Alabama and wanted to see if we could subcontract on these foreign embassies. These guys were blatant and right in front of us said, "We use foreign companies because of the labor cost and the supply cost."

I pursued it again two years later to try and get in front of these guys. I don't want to name names. I don't know if you want me to name names of these two companies but we submitted bids as a subcontract for the cladding of these embassies and couldn't get any response back from them. I finally got hold of the guys and one of the companies told me that they partnered with another company in Turkey.

If we wanted our bid to even be looked at, that I needed to touch base with this company called Inca out of Turkey. I was just astounded at the fact that they are not using U.S. labor. They are not even interested in talking to us. We spent money and effort in putting these proposals together and we're getting kicked under the bus so a Turkish company can be utilized not only to purchase the materials but also install the materials.

I feel like we have a capable team to get in there and not only improve the quality of what's getting done, but also improve probably the safety of it and security. We are a service-disabled veteran-owned company and we are going to approach it the proper way as far as getting the building put up, the exterior of the building. I feel like I have faced a brick wall with this one.

Chairman NYE. Okay. You mentioned in your testimony you feel like the set-asides for service-disabled small businesses is essentially an honor program that very few honor. Tell me how do you feel about your reception when you talked to the primes or to the actual contracting officer about the rules they are supposed to be following.

Mr. INGRAHAM. It's frustrating. I mean, the majority of the companies that are service disabled the people that are doing it right are at a disadvantage. They have to do either 15 or 50 percent of the labor themselves. These shell companies make it very difficult for us to compete with that. It is on the honor system and it needs to be verified.

Chairman NYE. What steps could be take, do you think, that would be the most effective in providing you the opportunity to compete most fairly for these contract dollars?

Mr. ARMBRUSTER. I mean, I feel like that a system of verification not only for the prime contracts that GAO did that study on it and found out that there was 10 of them on the prime contracts that were fraudulent. But you figure if they are even trying to hit on the subcontractor it is supposed to be 3 percent service-disabled vet

goals, one, you need to find out the ones that are being awarded the contract or are they just a shell company, are they just asked for, "Hey, give me 3 percent of the contract value and you can use my name."

Are we competing against that? That would help. I think setting out specific goals for the contracting officers to say, "Hey, you have to set aside 3 percent of the work and verify after the contract has been done is the general contractor going to use service-disabled veteran companies." Out of the 119 jobs that we bid last year, we have gotten three. We are constantly told that we are not the absolute lowest bidder. I have a letter here today from a company that says, "You have to be the lowest bidder."

It's just not fair. We can't compete with large business. I just lost a job two weeks ago to the Naval Academy to two large businesses and we were the lowest small business in there with a price but, "You weren't the ultimate lowest bidder." I think a plan needs to be developed for the contracting officers and an enforceable plan at that. If there's no penalties, these guys are going to continue doing the same old things in the construction field and we're going to die on the vine bottom line.

Chairman NYE. Okay. I appreciate that.

Mr. Roller, I want to follow up with you on a couple of things you mentioned in your testimony. I'm particularly interested to hear in a little bit more detail about your interactions with the contracting officer who you were essentially routed back to who had made the decision about the original award. Can you talk to us about how effective or not effective it is to have that be the route of your complaint and what can we do to fix that?

Mr. ROLLER. I think it comes down to individual contracting officers. In this particular case we actually sent evidence directly to the contracting officers. It was basically two websites that had the two firms who have common ownership. One was $100 million plus company. The other one was an SDV small business.

On their websites they actually bragged about the affiliation between the two parties. This is a branch of this business and our sister company is the $100 million business. We sent that directly to the contracting officer which, in my opinion, was clear evidence that we have a direct affiliation. The word affiliation was even used on the website pages which is an absolute no-no. In our opinion that should have dismissed that bid right away. I mean, it was clear, it was blatant. It's right there in black and white.

The contracting officer went back to this company and said, "Hey, here is what's on the table. Produce evidence to the contrary." What essentially happened was two days later both websites were changed for both companies and the contracting officer came back to us and said, "They appear to me to be an SDV business. If you would like to protest, you may certainly do so or you can take this up with the area SBA for size determination of this SDV," which is what we did.

Chairman NYE. Okay. And where did that go?

Mr. ROLLER. After looking at the two websites the SBA said, "Absolutely this is a problem." It took them several days. In the meantime the website was changed. Both of them were changed. I even sent another email back to the SBA to say, "Both websites have

been changed. If that is not another indictment of what is going on, I am not sure what else I can do here."

The SBA came back and said, "Although it looks legitimate that they are not a small business, we are going to refer this back to the contracting officer and you need to start there."

Chairman NYE. You mean they suggested they would refer it back to the contracting officer in the hopes that there would be some kind of different outcome this time?

Mr. ROLLER. I think in the hopes that we would protest. At that point we could have protested but it was actually five days after the award. You have five days to protest it. At that point we have an SDV that is clearly affiliated with a large business that is $100 million plus. We are a small business doing, you know, $2 or $3 million a year. Financially our resources I just didn't have it to pursue a contract in which we were third in place anyway.

The alleged SDV that was a large business was No. 1. There was a second company and then there was us. The second company clearly did not want to get involved in protesting. I had a direct conversation with the president of that company because he did not want to create waves with that particular agency since he had already received a number of contracts from them.

Chairman NYE. Okay. I just want to make sure we highlight what options you feel like were available to you to resolve this problem in terms of your being a small business. Can you describe what kind of a burden does that place on you to have to be the one to go after them?

Mr. ROLLER. The cliche is you always hear, "For the price of a stamp you can protest this." Sure, you can but then there are other steps to go through after that. Like most legitimate SDVs we've gone through a lot of financial processes here with our attorneys and with accountants to make sure we are legitimate and then we are by the book.

Likewise, if I am going to protest something, I would reach out to my attorney and say, "I am getting ready to protest this thing. I want to make sure the language is right and I want to make sure I'm not doing anything wrong." There is a cost associated with that. Those are really our options.

Chairman NYE. Do you believe that the SBA took your complaint seriously and that the mechanism just doesn't exist for follow-up or where was the breakdown?

Mr. ROLLER. In my opinion, and I highlighted this in my testimony, the lack of oversight by any one agency, the SBA says it is the VA's problem. The VA says it is the SBA's problem. The GAO says, "Both of you have a problem." Somebody has got to own it and somebody has got to say, "We verify SDVs and the rest of you can use it throughout the federal procurement community."

The buck has got to stop with somebody be it the VA or the SBA, one of the two. Our options in my opinion were to protest, go through a lengthy process. Some large businesses, as an example, will not protest contractor awards because they do not want to reflect badly with the contracting officer. They figure other opportunities will come up somewhere down the road with this contracting officer.

In looking at that as a small business when you are out there trying to develop relationships, you know, your first impression with a contracting officer you don't want to make it as protesting an award. That is usually not a good start. In this case we felt like what we sent the contracting officer was really helping them out to legitimize who they are getting ready to make an award to.

Chairman NYE. And they didn't take advantage of that information.

Mr. ROLLER. And they did not take advantage.

Chairman NYE. Okay. Well, I can certainly sympathize with the challenges you face. I think you said quite well in your testimony that what has to happen is that the price for noncompliance has to outweigh the benefit for noncompliance and we found in many cases that is not what is happening right now.

That is a good segue. I want to actually transition over to Mr. Kutz. I want to talk to you a little bit about some of the things we have learned since your report came out in November which highlighted a large degree of fraud within the service-disabled veteran program and just to reestablish the baseline here. Can you talk to us about how you collected the pool, how you narrowed it down of the original complaints and then what percentage and what do we think that means for the broader universe of potential fraud in the system.

Mr. KUTZ. The pool at that time was over a hundred allegations we had received through our hotline and others out there who are in the industry. We only had time really to do 10. These are comprehensive investigations. We did surprise field visits and other collaboration and corroboration of information.

At the time I testified before the full Committee back in November it was 100 plus so we did the 10. Since then we have received dozens and perhaps even 100 more from various veterans and others who see the same types of things happening because there still really is no mechanism to protect legitimate veteran firms who are trying to be honest and do the right thing in this program.

That 10 is not a statistical sample. It's not something you can project but still I think it is fairly representative of the types of things that are going on in this program as we speak.

Chairman NYE. Whether it is statistically valid or not accurate, for measuring purposes it's still a hundred percent of the ones that you chose to pursue of the complaints presented revealed that there was fraud of some kind. Is that correct?

Mr. KUTZ. That's correct.

Chairman NYE. Okay. I want to talk a little bit about the slide that you presented to us and I think that is an interesting presentation about the various levels of protection against fraud including a consequence level to try to help us prevent this in the future. Can you just talk to us a little bit about where we are currently as opposed to where we ought to be on this chart. How big is the gap between those things?

Mr. KUTZ. Well, if this were a marathon we would be in the first several miles quite frankly. I think the only place we have seen any progress is at the Department of Veterans Affairs where you have the certification program that is still in its infancy, if you will. They have certified several thousand firms. Of course, two of the

10 fraud cases had been certified through that process so that is not encouraging necessarily.

Hopefully they have learned from what we have shown them about those firms and have taken that into account. SBA is really no where at this point. There has been a lot of talk. They still have the bid protest process but in the bid protest process eight of the 10 companies that we identified as fraud are still in the central contract registry as being self-certified as service-disabled veteran-owned small businesses.

When you go outside of the Veterans Affairs Department where they are competing for contracts they still appear to the contracting officers to be legitimate firms. Like I said, I think we are in the first several miles of a marathon and this is going to require years of Congressional oversight to make this important program right and to make sure the legitimate firms are the ones that are getting the work.

Chairman NYE. What do you think the holdups are on the SBA system? Why is it that firms can still be revealing themselves in the system if they are under protest without some kind of flag? Is that a legal question or is that just a question of the execution of the program under the SBA?

Mr. KUTZ. I think one of us mentioned it. The only thing SBA has going is their bid protest process. Even when they have found firms to be ineligible, they pretty much said to the other agencies, "It is your issue." They have not suspended or debarred anyone. They don't really kick anybody out of the program because, as I mentioned, eight of the 10 that we found as fraud are still sitting in CCR as looking like legitimate service-disabled firms.

SBA has got the bid protest thing. Now, they have said with bid protest they are now going to tell people they have 30 days to get out if they have been found to have an ineligible firm and were ruled against or they will be referred to the IG so they are trying to put a little bit more teeth in it. For the most part SBA is at the starting gate really.

Chairman NYE. So the SBA essentially refers to the enforcement back to the contracting officer as you heard in the case of the businesses that are here today and lets them make the decision, the same contracting officer that made the original award, and essentially puts the onus back on that person to decide what to do.

Mr. KUTZ. That is correct. The only difference now we understand is they are referring those that don't take themselves out of the system to the Inspector General at SBA and that has just happened recently, I believe.

Chairman NYE. Okay. I did ask the Inspector General at the SBA in a recent Committee hearing about what actions they were taking and she did testify, I believe, that they were taking some to prosecution but couldn't comment at the time on the details because of the process but we will be following up to find out more about that.

Let us just go back to the contracting officers then because that seems to be where the onus is constantly returning. What did you find in your investigations in terms of the contracting officer's awareness of the law and the problem and what methods were available for them to solve it?

Mr. KUTZ. Well, unfortunately, in the 10 cases they were well aware of what was going on. In fact, they helped facilitate what was going on in some of these cases. They would find a large company they wanted to do the work. They would help facilitate the front company in some of these cases so they new exactly what was going on so they not only were not there to prevent what was going on, they were facilitating it.

I don't think they were always involved in fraud necessarily. They were looking to get those requirements you mentioned in your opening statement that are so important to them that they get the work out and they can score it as a small business. That means that the reports you are getting back are saying that a certain amount of small business work is being done but really there are large international companies.

I mentioned the one at the hearing last November. It was a company from Copenhagen, Denmark doing the janitorial services work at a VA hospital in Palo Alto, California. It was an outrageous case and that would have been shown to you members of Congress as a successful small business service-disabled contract.

Chairman NYE. Can you see any elements of effective fraud prevention that are coming online soon that will be helpful in moving us towards the goal that you laid out in your slide?

Mr. KUTZ. Certainly at VA they are moving forward with their certification process. There have been several thousand firms certified but I understand there are many thousands more waiting in the queue so the other unintended consequence here of the certification program are potentially legitimate firms sitting in the queue waiting to be certified for a year or more. Now what we have is a negative consequence of trying to do the right thing here with the certification program. It is just an under-funded program over at the VA.

They don't have enough resources into this. They have done very few site visits so they are still doing a paper shuffle to a large extent and I'm not sure they are getting the right results in all cases but that is the only place we've seen significant progress. Part of that was because they were mandated by law to do it. Otherwise there was nothing there. Really the hearing you had last November spurred them to really kick-start this into action.

Chairman NYE. Let me follow up on the question about the backlog and how much of an impetus that is for folks that want to get involved.

Ms. Walters, can you comment on your experience dealing with disabled-veteran business owners trying to get into the process, or generally with the broader small business community, the backlog now in terms of certification is that creating a significant problem as far as you have seen?

Ms. WALTERS. Well, as you had indicated, the only certification process now is with the VA. It is very backlogged. I think if you look at SBAs basket of management and policing activities, historically if you looked at things like HubZone now created after we looked at that having to go out and do site visits. There just are not enough resources, I believe, for SBA to actually pull off by themselves another certification program for the VA.

I believe you are correct somewhere a thousand of these certifications have been done. We are starting to see as more and more veterans are asking to be certified by VA it is becoming more and more backlogged. I mean, we are looking at potentially 90 days, 120 days. As you put the onus then on the folks who are trying to do the right thing, they are losing opportunities.

Then you add the additional variables and getting back—and I kind of want to move back to that a little bit and I'm sorry—getting back to the contracting officers and where they are looking and the CCR registration. The only requirement that they have is that a service-disabled veteran-owned small business certify themselves to the contracting officer that they are that.

In effect, if they are going to look at CCR and they are looking at the certs and reps and they have done that, the contracting officer then by law is only required to accept that. I think that one of the areas that we really need to push back on is the area where the contracts are being let at the contracting officer's point. If we can actually do a better job of legislating more requirements for the contracting officer to have to do before these things get awarded, we may be able then to curtail trying to strategize more policing of these things after they happen.

I think, like you said, the certification process like any certification process, the HubZone, the 8(a), it just gets further and further and further backlogged and it becomes frustrating for veterans to have to go through certifications when they are trying to do the right thing.

Chairman NYE. I want to follow up on something you said during your testimony about not favoring too many policing functions at the SBA that could tend to slow down the process. I just want to make sure I understand what you mean about trying to find the right balance between putting more onus on the SBA in terms of their enforcement and getting back to the contracting officer and force to do the job of ensuring that the contract recipients actually quality. How do we strike the right balance there?

Ms. WALTERS. Well, I think if we look historically on the set-aside programs that SBA has in their basket where they are trying to do the policing, if you look specifically in the small business set-aside program, you will see that I would say nine times out of 10 the only time that we have an issue where a small business set-aside has been given inadvertently to a non-small business is when another business protested. It is not when we are looking at trying to police it.

I don't think that the SBA has enough resources in enough places to put boots on the ground to do physical site inspections of HubZone certifications of now a potentially additional service-disabled veteran and small business certification.

I don't think that is where we need to keep pushing on that side of the basket when in my opinion where the contract is let at the contracting officer who has a tremendous amount of authority and judgment to award a contract. They have at their disposal DCAA and DCMA to do some of these surveys before they let it go out of the door. I think if we push more down into that area, maybe then we can begin to strike a balance and we just saw it in this instance.

I don't think only having the contracting officer look at a self-certification and say, "That is enough for me. I am going to award the contract." And then when it gets out the door somebody else can police it. Somebody else can worry about it. Veterans are losing opportunities. Okay. And then all of a sudden months later somehow it makes a circle back to the contracting officer I don't think is the appropriate balance.

Chairman NYE. You mentioned that in some cases there is unintentional fraud involving a veteran who is making best efforts to meet the rules. Can you offer some examples of that and how big of an issue is that?

Ms. WALTERS. Absolutely. I have actually had clients—well, first, I can tell you I have large businesses that call me. Some of the things that people will say to you is absolutely astounding. I have large businesses that will call me and say, "I want to do so and so and so and so but I can't. I need a service-disabled vet-owned business. Can you hook me up with somebody?"

I have constantly had clients coming and sitting down in my office, service-disabled veteran-owned businesses, two-men and five-men size businesses, small shops, who say, "I have been working with another company." Or, "I had this company call me, a large small business call me, and they want to do a teaming agreement with me so I went ahead and did a teaming agreement with them."

Or, "I went ahead and started the process of doing a joint venture without a lawyer, without any assistance from anybody because they said they can bring onboard and help me with my capital. They can help me with past performance. All I have to do is go out and find some service-disabled veteran-owned small set-asides to get involved in." I say, "Can you bring me the documents that you signed? What did you do?"

When I take a look at this stuff, I realize that they have been captured exclusively in some agreements that then allow the execution of fraudulent contracts to them that now 85 or 90 percent of the work is really owned by these other companies. That is actually, I think, more frequently happening than people realize. I see a lot of people coming in the door after they have gotten caught up in something.

Chairman NYE. So, in that case, the veteran-owned business may be unaware of the problem but there is a business involved in the transaction that knows what it is doing.

Ms. WALTERS. Yes. That is when I talk about these are companies that probably have gamed the system along the way. They have done this with other companies. They have done it with minority-owned companies, women-owned companies, wherever they can find the ability to get a piece of the pie that they can't get elsewhere.

Now there really are because we do have a focus on increasing the goals for service-disabled veteran-owned businesses and getting closer to the goal. There is more and more money going there. They are now preying on service-disabled veteran-owned small businesses.

Chairman NYE. I see what you mean. Do you have contact through the course of your work with contracting officers themselves?

Ms. WALTERS. Absolutely. I talk to contracting officers quite extensively.

Chairman NYE. And can you describe your feeling about their level of knowledge and involvement in the problem areas here?

Ms. WALTERS. I think from the ones that I've talked to they realize that there is a problem but for a contracting officer the Federal Acquisition Regulations are the Bible. They go back to the FAR and what the FAR states is a self-certifying process. I have had instances where I have advocated to them that they utilize a pre-award survey.

I have advocated to them that they listen to folks like Mr. Roller when they come and say, by any means, whether it is a phone call, a letter, regardless of what time in the process it is, whether it is the proposal process or months or years after an award is made, if a veteran comes to you and says, "I have a problem and I do not believe that this other company is a service-disabled veteran-owned business," they should act immediately as any of us who are in any type of a federally-funded type of program. We should take that information and really, really investigate it.

Chairman NYE. Let me ask you generally where on the scale of challenges does this kind of thing fall for you and the veteran-owned small businesses that you work with and what are the greatest challenges that they present to you in terms of asking for your assistance?

Ms. Cavolt, I am going to ask you the same question after Ms. Walters answers.

Ms. WALTERS. I think their greatest challenge, the most questions that I get from them are first off—well, second off, how do I access the procurement system and how do I prepare a good proposal. First off is, "How do I make myself a legitimate service-disabled veteran-owned small business to do federal contracting legitimately?" "

How do I engage with other businesses legitimately to make sure that when we go out and we try and garner a set-aside for us that we have done it in a legitimate way?"

Then, thirdly, I get many that come to me after something has already happened. "How do I get out of this joint venture or this teaming agreement or this thing that I have done with myself and my business that now appears eight months down the road that we have done something we shouldn't have done?" Or, "They are mistreating me or not giving me the scope of work that they agreed to in a subcontract so that I can meet a subcontracting goal for them." I think those are the most of the challenges.

Chairman NYE. Okay. Thank you.

Ms. Cavolt, will you talk about your experience dealing with veteran small businesses, what their great challenges are, and what is your experience in this area.

Ms. CAVOLT. We have had kind of a dual challenge there. One is we are manufacturers. We make very specialized products as you are aware. As I had said earlier, we make medical products for the military. The military members come to us and they say, "This is what we need." It is life-saving materials and they say, "This is what we need." We say, "How do you want to carry it?"

We design the bag. It is a very long process. We had one that took a couple of years to actually develop. You know, what happens, and this is a comment on contracting, but at ECC here in Norfolk they want our item. We are in Virginia Beach. We can provide it. They actually will ask us for a bid. We give a bid and it goes to the contract office. The contract office puts it out and goes to a company in Florida. It goes somewhere to a business that doesn't even do what we do and we end up going through them and it is the only way we can get our products out there.

First of all, it is costing the government anywhere from 30 to 40 percent on top of what we charge so it is a pretty expensive administrative fee. We have asked the contracting officers, "Can you set it aside? Can you do a set-aside?" They will say, "Well, we don't know if we can get a couple service-disabled veterans in this area."

Chairman NYE. Is that right?

Ms. CAVOLT. You know, come on. As you know, we are the largest concentration of retirees of veterans. Just getting the contracting officer to even look at the idea of doing SDVOSBs. We do have a company here in town who if a contract comes up they have their avenues. They can pull an 8(a). They can pull a women-owned business. They can pull SDVs.

I mean, as an example, I saw some of our products on eMall which is a way that the government can purchase products and I saw ours. I didn't know who this company was. I also noticed that they were marked up about 40 percent but they were over the micro-threshold which is the $3,000 limit so they are making the sales. The bag is coming from us. It is costing the government a lot. We are not getting the past performance so we are still back at square one.

There is a great reluctance of contracting officers. First of all, I get the attitude that, "Yeah, we will do it," but then the next thing you know it has been awarded to someone outside other than a service-disabled veteran-owned small business.

Interestingly I have done a little research in the FARs and the requirement is that two businesses, two service-disabled veteran-owned small businesses, need to bid on a contract for a set-aside. If only one actually returns a bid, they are required to award that bid to the one offer. So, you know, it gets dismissed all the time.

You are familiar with some of the experiences that I have had just outside of this hearing and I always come back to contracting. There is a micro-threshold of $3,000 so they are trying to handle everything from $3,000 to $50 million in contracting. They are likely to throw a lot of things, you know, the fastest way that they can manage it.

Like you said, they want to hit their scores so they are just opening the book, "Okay, let us pick that one." You know, as Mr. Roller said, he didn't have the resources. I am sure that included time as well. As a small business you are working 24/7 it seems and that is just to keep things moving so it is difficult.

Just one other thing I would like to mention is sometimes when you do go up against large businesses, you mentioned about being concerned about getting blackballed, so to speak, within a contract office. We have had these large businesses come after us legally

and try to sue us for some trumped-up idea and we always get it thrown—you know, it doesn't get very far but it is intimidation.

Chairman NYE. Ms. Walters, can you comment on your feelings on that? We are in a very heavy military area. We have a lot of military contracting officers in this area that are contracting out work on a day-to-day basis. Can you talk a little bit about your work with those contracting officers and how you feel they approach local businesses and their awareness of the service-disabled business community here.

Ms. WALTERS. First let me say that I do believe that the Federal Acquisition Work Force is under-resourced. The contracting community over the years has gone through several different cycles. We went through a time when we had a lot of bundling of contracts where a contracting officer may be required to spend time on five contracts.

Then that did not provide enough opportunity for small businesses so we went through a cycle of unbundling so that small businesses could receive contracts. You could have a contracting officer trying to manage 80 to 100 various contracts.

All of the contracting officers that I have spoken with, or that I work with, are very well aware of the goals and requirements of their Department to meet for service-disabled veteran-owned small businesses. There are several different councils like the Tidewater Government Industry Council where actual contracting officers sit with industry representatives and talk about these type of issues regarding in-sourcing, out-sourcing.

That is a big issue right now among small businesses. I think they are very well aware that service-disabled veteran-owned small businesses exist. It is always astonishing to me when there is a sources sought put out for service-disabled veteran-owned small businesses to respond to before a contracting officer will set aside something to ensure that there are at least two out there.

I do see a lot of service-disabled veteran-owned small businesses responding and then when the procurement comes out it is actually not set aside. I have seen that probably more often than I would like to see that. Then I never know what happens behind the scene whether there is a change in the funding or budget to that agency for the programs, whether or not they decided that they have met a goal and are now pushing away from that particular goal onto another one. I don't know what goes on behind the scenes.

Chairman NYE. Can you just mention—I want to note that the SBA recently designated your center as a veterans business outreach center. What does that do in terms of your abilities and resources for the coming years? What kind of additional capabilities will you have?

Ms. WALTERS. We actually are looking at four different areas that we are going to increase the scope of opportunities. The first being, and one that is really important to me, is a mentor protege program. Fortunately our partner, the Hampton Roads Service-Disabled Veteran-Owned Small Business Council, which Mr. Roller is part of, as others are here in the room, they are a large council organization of very reputable service-disabled veteran-owned small businesses.

They have come on board with the idea to assist in creating a mentor protege program here in the local area where when we have folks that come in the door we can then vet them and marry their companies up with the appropriate person in their industry and their companies will mentor them. I think that is something that we would not be capable of doing if we didn't have the outreach center. That is a number one priority for us.

Chairman NYE. Great. I appreciate you mentioning that. I wanted to highlight that. I also want to note that I have heard, not just today, but a number of local small veteran-owned businesses that we can put a lot of effort into mentoring and providing resources for help with understanding the contracting process.

At the end of the day if the process is broken, there is a big problem that we still need to fix. Thank you for continuing to do your work on that and for being here to highlight the challenges that are beyond what you can do in your day-to-day capacity in terms of being an adviser to our small businesses and how to approach the system.

Mr. Kutz, I want to actually just get back to another question that you mentioned, that at the end of the day it comes down to the consequences side of the equation. If there are none, clearly that provides a strong lack of disincentive for businesses and business owners to take advantage of the system and defraud our veteran-owned small businesses.

I wanted you to tell us a little bit about some consequences that you think would be useful in terms of applying here. I want to note also the bill that I mentioned in my opening statement that I proposed we provide for criminal prosecution for any business owners that knowingly take advantage of the system and defraud our veterans but can you tell us kind of what the range of consequences looks like and give us kind of a guideline that we could follow.

Mr. KUTZ. Right. First of all, the contracts that they get through fraudulent means should be taken away. Certainly future options from those should be taken away. Companies should be decertified or somehow taken out of CCR and any place else that would give them any level of credibility as a service-disabled veteran-owned small business, and then up the scale to suspension meaning that they couldn't get future work, debarment which is typically a longer term process but can also result in a longer-term denial of future federal work.

As you mentioned, the prosecution, as I mentioned in my opening statement, if you don't have any poster children of people who pay consequences at the end of the day for fraud, then people will continue to try to game the system because they don't believe there is any chance of getting caught.

Let me give you an example. One of our cases was the person wasn't even a service-disabled veteran. They got $7.5 million of FEMA contracts for Katrina and their attorney advised them to lie because there was little or no chance of getting caught. Even if they got caught, nothing would happen. As it turns out so far, that attorney is correct.

Chairman NYE. Clearly that is something we've got to change. Can you talk a little bit about other programs and how does the fraud that you uncovered in the service-disabled program compare

with levels that you might find in 8(a) or HubZone programs? I'm trying to establish in relative terms how rampant is the fraud in the service-disabled program.

Mr. KUTZ. It is probably more rampant in this than the other two just because this is a complete self-certification program, although we can't project that. Based on the allegations we are getting on our hotline and other indicators it would seem to be more prevalent. One common thing that we have talked about, and Michael has talked about with me also, Michael Day, is this pass-through is common amongst this program where you have some sort of a front organization and the work is getting passed through to a large business. We have seen that happening in the HubZone, 8(a) and service-disabled veteran. I think from a prevalence standpoint if I were to guess, and that is all I can do is guess because I don't know for sure, I expect that the fraud rate is higher in this program.

Chairman NYE. I want to offer to our businesses testifying today an opportunity to comment on how they have interacted with any of the services through the American Legion or the procurement assistance center here. If you have any experience with that you would like to share, I would be happy to hear that at this setting. Or advice for things that you think would be helpful to us to have locally in the future that could help businesses like you do better.

I also want as an open-ended opportunity to offer you a chance to comment on anything you have heard from the other folks at the table and provide any additional thoughts about ways we could improve the accountability in this system.

I would also offer an opportunity if you want to comment on our proposal about prosecution of folks for taking advantage of the system. Mr. Roller.

Mr. ROLLER. I would like to start out by saying the testimony that Ms. Walters gave earlier about legislation at the contracting officer level, that comes with a two-edged sword. Putting more responsibility on the contracting officers is a good step. However, they are already overtaxed with the amount of work they are doing.

Outside of the Department for Veterans Affairs if you place more responsibilities, more workload on contracting officers, they may in turn set fewer projects aside as SDV set-asides because the amount of workload that goes with that and, in turn, look at HubZone or 8(a)s which requires a little bit less work or even large business that requires even less work. I just want to be careful of that.

As far as locally the Veterans Outreach Center with HRPAC is absolutely needed in this area. Again, when I started my business we sought counsel with our attorneys to make sure we were legitimately putting things together and that we were not in violation of any regulations. That comes with a cost and on average that is anywhere from $5,000 to $10,000 to $20,000 depending on what type of business you are getting into.

It is certainly a resource to start off with to say how would you go about putting together an SDV business. Or, "I am an SDV. How can I get my business certified through the program and what are some of the legal steps I need to take?" would certainly save you some money with one of these outreach programs.

Also, the discussion of bonding, finances, banking, all those things are needed with small SDVs just getting started and the resources are limited. A lot of times small SDVs turn to large business as mentors in helping them get started or even some other small businesses. Sometimes that is how they end up with some of these team agreements that don't meet the Federal Acquisition Regulation guidelines.

The small business SDV owner feels he owes it to somebody to get some contracts with them because they helped them get started in the business. I can certainly see how that can come about. The outreach is definitely the first place to start here locally.

Chairman NYE. Okay. Thank you.

Mr. INGRAHAM. I would have to agree 100 percent. The outreach program and also the Service-Disabled Veteran-Owned Small Business Council is a nice avenue that is partnering with Ms. Walters also. I think that is a great step forward for helping veterans that have an idea that want to take it to the next step and how they do it properly.

Chairman NYE. Thank you for mentioning that. I want to take the opportunity also to congratulate the Service-Disabled Veteran-Owned Small Business Council locally for all the work that they have been doing. I really appreciate that. I note that there are some other members of the council here present in the audience today with us so thank you for everything you have been doing.

I want to offer the opportunity now for any of the folks at the table here to add any comments that they would like that I didn't ask about or if there is any follow-up comments anybody wants to make sure to add into the record before we close. I just want to make sure I didn't miss giving everybody the opportunity to say everything they felt like they wanted to say.

Mr. KUTZ. Mr. Chairman, I have a couple of things I will mention to you.

Chairman NYE. Yes, Mr. Kutz.

Mr. KUTZ. I think your legislation is a good step with respect to prosecution. I think it wouldn't hurt, too, for the Committee to work with the Department of Justice to try to make it a priority for U.S. Attorneys across the country to take at least a few cases a year. We are hopeful that a couple of these 10 will make it to a U.S. Attorney. We have some hope in Idaho, for example, one of our cases may make it to grand jury for indictment.

Just a couple of cases a year even though they may not be big priorities for DOJ and the U.S. Attorneys would be helpful just to send a message again and you could help publicize those cases that this behavior is not something that should be tolerated and it will not be accepted.

Also, I just want to update you. Of these 10 companies again subsequent to your hearing in November of last year five of them have received another $5 million of new obligations related to new service-disabled set-aside and sole-source contracts so they are still in there and they are still getting more contracts fraudulently.

They also got another $10 million of 8(a) and other contracts subsequent to your hearing. To add insult to injury, they have received millions of dollars of Recovery Act contracts so you can see the consequences of not being suspended or debarred they are going to

continue to be out there and who knows what other kinds of frauds they have perpetrated against our government related to these various things.

The last thing I would say to the Subcommittee and the full Committee is to continue your oversight of these small business programs because it is important if you are supporters of these programs you have to be supporters of the integrity of these programs to make sure that the right people are getting the business.

I believe taxpayers for the most part will support these programs but not if the integrity issues that keep coming up happen. I think they want the business to go to veterans in these cases. Certainly your continued oversight of this I think is a positive step to keep the pressure because sunshine on dark places actually helps.

Chairman NYE. I appreciate that. Thank you, Mr. Kutz and thank you for taking the effort to look into those 10 cases that you did. You have revealed to us a level of detail which is useful to us in terms of making some changes to help prevent this in the future.

Clearly it is inexcusable that since we brought this to light through your report last November five other companies found to have perpetrated fraudulent behavior have continued to receive contracts. This just underscores the fact that there is no enforcement mechanism present that actually works.

What we want to get to here at the end of the day is an accountable system whereby taxpayers can trust that the money that they have agreed to set aside for our service-disabled veteran-owned small businesses is actually going to legitimate service-disabled small businesses for them to be able to do the work they do.

As Mr. Roller mentioned in his testimony, vets hire vets. One of the great values of this system is when we make sure that a certain level of contract dollars go to veteran-owned businesses we know that they will in turn higher other veterans. That is a proven benefit to our veteran community, to those who have served our country in uniform.

It is a benefit that I think taxpayers agree with doing but we owe it to the taxpayers as members of Congress to make sure that those taxpayer dollars are being used for the program as intended. I think we owe it to the service-disabled veteran community to make sure we do the investigations that shed light on whether the numbers the agencies are providing us are accurate or not because when they complain to us that there are some problems in the system and we go find that the numbers aren't right, we realize they are absolutely correct in the complaints that they raise with us.

It is incumbent upon us, of course, to make sure to continue to practice that oversight and to make the legislative changes that we need to make to solve the conundrum that Mr. Roller so aptly described in his testimony today whereby the price of consequences is so low in terms of perpetrating fraud that there is no disincentive in the system right now to prevent unscrupulous business owners from defrauding our veterans and that is something we are going to change.

I appreciate you taking the time to come be with us, Mr. Kutz, to the GAO for looking into this.

And Ms. Cavolt and Ms. Walters for the efforts that you do through your organizations to help our veteran community ap-

proach business issues and help them navigate the often complicated world of government procurement. And to our business owners for taking the risk and the effort to go out there and make things happen in the local economy and do business and create jobs and economic growth.

We appreciate the challenges you face. We are going to do what we can to help make this playing field as fair for you as possible and as transparent as possible. Again, I want to say thanks to the other members of the audience who came to be with us today, especially the other members of the small business community, the service-disabled veteran community particularly for all the work that they do every day to help grow our local economy.

With that I want to thank everyone for their testimony and I will go ahead and adjourn this meeting.

[Whereupon, at 11:11 a.m., the Subcommittee was adjourned.]

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on Contracting and Technology, Committee on Small Business, House of Representatives

For Release on Delivery
Expected at 9:30 a.m. EDT
Monday, May 24, 2010

SERVICE-DISABLED VETERAN-OWNED SMALL BUSINESS PROGRAM

Fraud Prevention Controls Needed to Improve Program Integrity

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

GAO
Accountability * Integrity * Reliability

GAO-10-740T

GAO
Accountability·Integrity·Reliability

Highlights

Highlights of GAO-10-740T, a testimony to the Subcommittee on Contracting and Technology, Small Business Committee, House of Representatives

May 24, 2010

SERVICE-DISABLED VETERAN-OWNED SMALL BUSINESS PROGRAM

Fraud Prevention Controls Needed to Improve Program Integrity

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 2008, the Small Business Administration (SBA) reported $6.5 billion in sole-source, set-aside, and other SDVOSB contract awards. Testimonies GAO delivered on November 19 and December 16, 2009 identified millions of dollars in SDVOSB contracts that were awarded to ineligible firms, and weaknesses in fraud prevention controls at the SBA and VA which allowed ineligible firms to receive contracts.

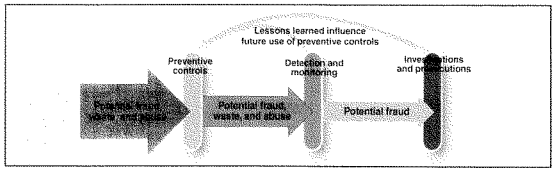
GAO was asked to testify about the key elements of a fraud prevention framework within the SDVOSB program, and to provide an update on the status of fraud referrals made based on the prior investigation of selected SDVOSB firms.

To address these objectives, GAO reviewed prior findings from audits and investigations of the SDVSOB program and contacted investigative agency officials concerning the referrals GAO made on prior work. GAO also reviewed applicable guidance on internal control standards from the Comptroller General's *Standards for Internal Controls in the Federal Government.*

View GAO-10-740T or key components.
For more information, contact Gregory D. Kutz at (202) 512-6722 or kutzg@gao.gov.

What GAO Found

GAO found a lack of overarching government-wide prevention controls, a lack of validation of information provided by SDVOSB firms used to substantiate their eligibility for the program, non-existent monitoring of continued compliance with program requirements, and an ineffective process for investigating and prosecuting firms found abusing the program. The results of GAO's investigation serve to emphasize the overall lesson that a complete fraud prevention framework is necessary in order to minimize fraud, waste, and abuse within the SDVOSB program. The most effective and most efficient part of the framework involves the institution of rigorous controls at the beginning of the process for becoming eligible to bid on SDVOSB contracts. Next, active and continual monitoring of contractors performing SDVOSB contracts is also essential. Given the examples GAO identified of firms owned by a service-disabled veteran who subcontracted 100 percent of contract work to non-SDVOSB firms, it is essential that federal agencies monitor compliance with program rules after contract performance has begun. Finally, as shown in GAO's investigation, prevention and monitoring controls are not effective unless identified fraud is aggressively prosecuted or companies are suspended, debarred or otherwise held accountable. The figure below provides an overview of how preventive controls would help screen out the ineligible firms, and how monitoring controls and prosecutions can help further minimize the extent to which a program is vulnerable to fraud.



Source: GAO.

GAO's prior investigation into allegations of fraud and abuse within SDVOSB contracts found 10 firms that were ineligible for the program but received approximately $100 million in SDVOSB contracts. Upon completion of its investigation, GAO referred all 10 cases to various agency officials who had contracts with the firms, and each agency's Inspector General (IG). Based on the referrals, agencies have taken a variety of actions including the cancellation of existing contracts, termination of future contract options, and opening of civil and criminal investigations. IG officials have stated that many of their investigations are ongoing, and therefore details cannot be provided due to the risk of jeopardizing the investigation. These 10 companies have over $5 million in new SDVOSB sole-source and set-aside contact obligations since November 2009.

Mr. Chairman and Members of the Subcommittee:

Thank you for the opportunity to discuss fraud prevention within the Service-Disabled Veteran-Owned Small Business (SDVOSB) program. 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 SDVOSB program is an extension of this policy. It is also 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 in 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. 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[2] by one or more service-disabled veterans who manage and control[3] daily business operations. A firm must also qualify as a small business under the North American Industry Classification System (NAICS)[4] industry-size standards. Currently, in the governmentwide SDVOSB program, firm officials are allowed to self-certify themselves as being SDVOSB by attesting that they meet the criteria.

The Small Business Administration (SBA) which, along with federal procuring agencies, administers the SDVOSB program, reported in fiscal year 2008 that $6.5 billion[5] in federal contracts were awarded to firms that self-certified themselves as SDVOSBs. Government contracts to SDVOSBs accounted for only 1.5 percent of all government contract dollars paid in

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

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

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

[4]The North American Industry Classification System is the standard used by federal statistical agencies in classifying business establishment for the purpose of collecting, analyzing, and publishing statistical data related to the U.S. business economy.

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

fiscal year 2008. Since the SDVOSB program began, the government has not met its annual mandated goal of 3 percent.[6] 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[7] requires the Department of Veterans Affairs (VA) to maintain a database of SDVOSBs and Veteran-Owned Small Businesses (VOSB) so a contractor's 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 to promote economy, efficiency, and effectiveness in the acquisition processes. The Procurement Policy Office's primary focus is on the Federal Acquisition Regulation (FAR), the governmentwide regulation governing agency acquisitions of goods and services, including actions on SDVOSB set-aside and sole-source contracts.

Testimonies we presented on November 19 and December 16, 2009,[8] identified millions of dollars in SDVOSB contracts that were awarded to ineligible firms and weaknesses in fraud prevention controls at the SBA and VA that allowed ineligible firms to receive contracts. Problems highlighted in the testimonies included a lack of governmentwide controls, a lack of validation of information provided by SDVOSB firms used to substantiate their eligibility for the program, non-existent monitoring of continued compliance with program requirements, and an ineffective process for investigating and prosecuting firms found abusing the program. In addition, our work also found that VA's process for validating a firm's eligibility may not be effective because two of the firms we identified as ineligible were certified as SDVSOB program eligible firms through VA's verification process. The various areas of control

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

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

[8]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-10-255T (Washington, D.C.: Nov. 19, 2009); and *Service-Disabled Veteran-Owned Small Business Program: Case Studies Show Fraud and Abuse Allowed Ineligible Firms to Obtain Millions of Dollars in Contracts*, GAO-10-306T (Washington, D.C.: Dec. 16, 2009).

weaknesses resulted in little or no assurance that firms receiving contracts met SDVOSB criteria. Based on these findings, we made recommendations to the SBA and the VA to explore the feasibility of improving program controls and institute consequences for firms that misrepresent their eligibility for the program. VA and the SBA generally agreed with our recommendations and VA has begun developing a validation process for VOSBs and SDVOSBs receiving VA contracts. Yet at the conclusion or our prior investigation, SBA had not yet taken action to implement a governmentwide comprehensive fraud prevention framework for the SDVOSB program. Additionally, we provided a matter for congressional consideration that 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.

Given the Federal government's emphasis on providing contract dollars to SDVOSB firms, the billions of dollars spent annually on SDVOSB contracts, and weakness identified by GAO, it is imperative that the SBA, VA, and federal-agency contracting offices work together to implement comprehensive fraud prevention controls. My testimony today will (1) describe the key elements of a fraud prevention framework that is needed within the SDVOSB program and (2) provide an update on the status of fraud referrals we made based on our prior investigation of selected SDVOSB contractors.

To address our objectives, we reviewed prior findings from GAO audits and investigations of the SDVSOB program. We also reviewed applicable guidance on internal control standards from the Comptroller General's Standards for Internal Controls in the Federal Government.[9] We contacted SBA to determine changes since the issuance of our report. SBA reported conducting meetings with the VA and setting up a task force to address SDVOSB program weaknesses. Due to the short time frame on this request we were unable to determine whether SBA's actions will adequately address weaknesses previously identified. We conducted our audit work in May 2010 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

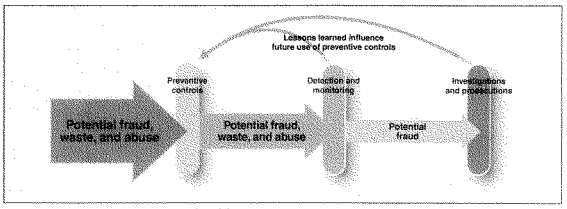
[9]The Federal Managers' Financial Integrity Act of 1982 (FMFIA) required that GAO issue standards for internal controls in government resulting in the issuance of *Internal Control: Standards for Internal Control in the Federal Government*, GAO/AIMD-98-21.3.1 (Washington, D.C.: November. 1999).

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.

Framework for Fraud Prevention, Detection, and Prosecution

The results of our investigation serve to emphasize the overall lesson that a complete fraud prevention framework is necessary in order to minimize fraud, waste, and abuse within the SDVOSB program. The most effective and most efficient part of the framework involves the institution of rigorous controls at the beginning of the process for becoming eligible to bid on SDVOSB contracts. Specifically, controls that validate firms' eligibility, including ownership and control by one or more service-disabled veterans, is the first and most important control. Next, active and continual monitoring of contractors performing SDVOSB contracts is also essential. Given the numerous examples we identified of firms owned by a service-disabled veteran who subcontracted 100 percent of contract work to non-SDVOSB firms, it is essential that program officials monitor compliance with program rules after contract performance has begun. Finally, as shown in our investigation, preventive and monitoring controls are not effective unless identified abusers are aggressively prosecuted and/or face other consequences such as suspension, debarment or termination of contracts and future contract options. The examples we identified of cases where SBA found a firm misrepresented its eligibility for the SDVOSB program, but failed to penalize the firm, undermine the positive effects of the few controls currently in place. Figure 1 provides an overview of how preventive controls serve as the first and most important part of the frame work because they are designed to screen out ineligible firms before they get service-disabled sole source or set-aside contracts. Monitoring controls and prosecution or other consequences also helps minimize the extent to which a program is vulnerable to fraud.

Figure 1: Framework Designed to Minimize Fraud, Waste, and Abuse



Source: GAO.

Preventive Controls Reduce the Potential for Fraud through Limiting Access to SDVOSB Contracts

Preventive controls are a key element of an effective fraud prevention framework and are also described in the Standards for Internal Controls in the Federal Government.[10] Preventive controls are especially important because they limit access to program resources through front-end controls. Our experience shows that once contracts are awarded and money disbursed to ineligible SDVOSB contractors, it is unlikely that any money will be recovered or even that the contract will be terminated. Preventive controls for the SDVOSB program should, at a minimum, be designed to verify that a firm seeking SDVOSB status is eligible for the program. However, during our investigation, we found that there are no governmentwide controls that verify whether firms who self-certify as SDVOSBs meet program requirements. VA performs some level of validation of contractors claiming to be SDVOSBs that bid on VA contracts, but even that process was primarily based on a review of self-reported data. The key to the validation process within the SDVOSB program must be verifying self-reported contractor data with independent third-party sources. Key data to validate with preventive controls should include whether the owner or owners are service-disabled veterans, whether the service-disabled veteran owner(s) manage and control daily operations, and whether the business qualifies as a small business under the primary NAICS industry-size standards for the SDVOSB contract awarded.

Validation of whether a business owner is a service-disabled veteran must be the first step in the SDVOSB prevention framework. Coordination

[10] GAO/AIMD-98-21.3.1.

between VA, SBA, and potentially DOD will be necessary to ensure an accurate determination is made. VA already maintains a database of service-disabled veterans, and therefore, it appears that data necessary for this validation are already available. However, during our investigation, we found that 1 of the 10 firms we investigated was owned by an individual who was not a service-disabled veteran, but received more than $7.5 million dollars in Federal Emergency Management Agency (FEMA) contracts. This firm is a prime example of why the relatively simple process of validating an individual's status as a service-disabled veteran can prevent fraud within the SDVOSB program.

In addition to the validation of firm owners' status as service-disabled veterans, preventive controls should also validate whether firm owners actually manage and control daily operations. This must be accomplished in order to prevent "rent-a-vet" situations where a firm finds a willing service-disabled veteran to pose as the "owner" of a firm while in reality, other ineligible firm members manage and control the daily operations of a business. One case uncovered during our investigation found that the service-disabled veteran owner actually played no part in business operations related to the primary government contracts won by the firm, and worked from home on non-government related contracts. The alleged owner also did not receive any salary from the firm and tax returns showed that he received less in Internal Revenue Service (IRS) 1099 distributions than the 10 percent minority owner. In order to identify these types of situations, controls must utilize a variety of tools including a review of independent third-party information such as individual and company tax returns obtained directly from the IRS. Other processes such as performing unannounced site visits to an applicant's place of business can provide evidence to indicate management and control of daily operations, whether the firm is a shell company operating with a mail box as an address or a legitimate firm with employees and assets and whether a firm is co-located with another non-SDVOSB firm that will likely perform all contract work. In our previous work, we used unannounced site visits when conducting our investigations of the 10 firms that through various fraudulent schemes, obtained $100 million in service-disabled sole-source and set-aside contracts.

Verification of whether a firm meets NAICS's industry-size standards is another part of preventive controls that can help minimize fraud and abuse within the program. During our investigation, we found that one company had violated small business size standards and received more than $171 million in federal contracts between fiscal years 2003 and 2009. We were able to identify the company's information through a review of contract

obligation information within the Federal Procurement Data System-Next Generation (FPDS-NG). FPDS-NG is a publicly available database that allows a user to search for federal contracts awarded to specific firms. As part of comprehensive preventive controls, a review of these types of databases as well as company IRS tax returns will provide information to ensure a prospective SDVOSB firm is not already a large business. Beyond validation of data and checks with independent third parties, it is also important that personnel performing the validation of a firm's SDVOSB status are well trained and aware of the potential for fraud. Fraud awareness training with frontline personnel is crucial to stropping fraud before it gains access to the program. Additionally, when implementing any new set of controls, it is important that agencies field test new controls and provide a safety net to deal with firms who feel they were inappropriately rejected from the SDVOSB program. Finally, a properly managed and staffed prevention program should not create a large backlog of legitimate firms attempting to be certified. Unfortunately, as GAO testified at the end of April,[11] VA's certification program has a large backlog of businesses awaiting site visits and some higher-risk businesses have been verified months before their site visits occurred or were scheduled to occur. Verifying businesses prior to site visits may allow ineligible firms to appear as eligible and to receive SDVOSB set-aside and sole-source contracts.

Monitoring and Detection Controls Provide Assurance That Firms in the SDVOSB Program Continue to Adhere to Eligibility Requirements

Even with effective preventive controls, there is substantial residual risk that firms that may have appeared to meet SDVOSB program requirements initially will violate program rules after being awarded SDVOSB contracts. Monitoring and detection are not as efficient or effective as prevention because once a contractors are in the program and fraudulently receive a SDVOSB sole-source or set-aside contract, there are few if any consequences if they are caught. Detection and monitoring efforts, which are addressed in the Standards for Internal Control in the Federal Government,[12] include data-mining of transactions and other reviews. Our investigation found cases where firms may have initially been able to meet a program's eligibility criteria, but subsequently violated subcontracting rules of the program after subcontracting 100 percent of the SDVOSB

[11]GAO, *Department of Veterans Affairs: Preliminary Observations on Issues Related to Contracting Opportunities for Veteran-Owned Small Businesses*, GAO-10-673T (Washington, D.C.: Apr. 29, 2010).

[12]GAO/AIMD-98-21.3.1.

contract work to a non-SDVOSB firm. Our findings therefore emphasize why it is important for a comprehensive fraud prevention framework to have detection and monitoring controls in place to identify violations. For the SDVOSB program, there are several areas that require periodic review, including monitoring of a firms compliance with industry-size standards and monitoring of the performance of required percentage of work on SDVOSB contracts.

In order to confirm that an SDVOSB firm continues to comply with NAICS standards, agencies should periodically data-mine FPDS-NG and other relevant federal procurement data to determine the number and size of contracts awarded and funds obligated to SDVOSB firms. A thorough review of this data is important so that all contacts awarded to a firm or its joint ventures are identified. During our investigation, we found one firm that received more than $171 million in federal funds through more than five different joint ventures. This example shows why data-mining efforts must be creative and thorough in order to effectively prevent fraud. In addition, data mining can also be done to review existing contracts with company information to determine whether a company could reasonably perform contracts given its area of expertise. For example, through data mining we found one firm during our investigation that initially listed its area of expertise as construction. However, the firm had recently been performing multiple janitorial service contracts across the country. While this was not a definite indicator of fraud, subsequent on-site unannounced site visits found that the firm was subcontracting 100 percent of the contract work to an international firm with more than $12 billion in annual revenues.

Monitoring of the firms active participation in contracts is another way to ensure SDVOSB program requirements are being met. During our work, we identified cases where firms, which may have initially appeared legitimate on paper, that actually functioning as pass-throughs and subcontracting 100 percent of the work to non-SDVOSB firms. Controls to help identify these situations would include conducting unannounced site visits to contract performance locations and contacting local contracting officers to determine with whom they interact during the contract performance period. In addition, a periodic review of the types of contracts awarded to a firm compared with company information can help identify firms requiring further review. Finally, when fraudulent activity is identified through data mining and monitoring controls, agencies should also use that information to help improve future preventive controls when appropriate.

Investigations and Prosecutions Serve as a Deterrent for Potential Future Abuse

The final element of a comprehensive fraud prevention framework is the aggressive investigation and prosecution of firms that abuse the SDVOSB program or other consequences such as suspension, debarment, and termination of contracts and cancellation of contract options. These back-end controls are often the most costly and least effective means of reducing fraud in a program. However, the deterrent value of prosecuting those who commit fraud sends the message that the government will not tolerate firms that falsely represent themselves as SDVOSB firms. Our investigation found that while the SBA has successfully identified multiple firms that falsely certified themselves as SDVOSB firms, in October of 2009 when we issued our report, SBA had not attempted to suspend or debar the problem firms. In addition, during our investigation, we could not find any examples of referrals for prosecution of these firms to the Department of Justice by the VA or SBA Inspectors General for fraud within the SDVOSB program. In order for the SBA and VA to ensure the highest level of compliance with SDVOSB program requirements, there must be consequences for those firms that chose to fraudulently misrepresent themselves as SDVOSB firms. Agencies have tools available such as suspension, debarment, and removal from the program, termination of contracts and cancellation of future contract options. Finally, as with fraud found through monitoring controls, lessons learned from investigations and prosecutions should be utilized to strengthen controls earlier in the process and improve the overall fraud prevention framework.

Referrals from GAO's Investigation Have Resulted in Action from Agency Inspector General Offices

Our prior investigation into allegations of fraud and abuse within SDVOSB contracts found 10 firms that were ineligible for the program but received approximately $100 million in SDVOSB contracts. Upon completion of our investigation, we referred all 10 cases to various agency officials who had contracts with the firms and to each agency's IG. Based on our referrals, agencies have taken a variety of actions including the termination of existing contracts, the decision not to extend contract performance by exercising future contract options, and the opening of civil and criminal investigations. IG officials have stated that most of their investigations are ongoing and that therefore, details cannot be provided because of the risk of jeopardizing the investigation. However, in at least one case, the future contract options under a janitorial services contract were not exercised and, the firm was not allowed to perform work beyond the initial contract performance period. In addition, this firm's subcontractor, which performed 100 percent of the contact work, initiated its own investigation. The subcontractor's investigation determined one of its employees helped to perpetrate the fraud by creating fictitious documents at the request of the SDVOSB firm's owner. In another case, the SDVOSB firm was found to

be intentionally overcharging a federal agency by inflating the hourly labor rate of unapproved subcontracted employees from a temporary employment agency. Finally, in one case, multiple federal investigative agencies have an ongoing criminal investigation and are working together on a grand jury indictment. Additionally, these 10 case-study firms have received more than $5 million in new contract obligations[13] on SDVOSB sole-source and set-aside contacts and more than $10 million in other new contract obligations since November 2009.

Conclusions

Our investigation of the SDVOSB program shows that existing controls are ineffective at minimizing the risk for fraud and abuse. Our 10 cases alone show that approximately $100 million in SDVOSB contracts have gone to ineligible firms. With billions of dollars being spent annually on SDVOSB contracts, agency officials should use lessons learned to implement a comprehensive fraud prevention framework. Controls at each point in the process are the key to minimizing the government's risk. With a comprehensive framework in place, the government can be more confident that the billions of dollars meant to help provide opportunities to our nation's service-disabled veterans actually make it to the intended beneficiaries.

Mr. Chairman and Members of the Subcommittee, this concludes my statement. I would be pleased to answer any questions that you or Members of the Subcommittee have at this time.

Contacts and Acknowledgments

For additional 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 statement.

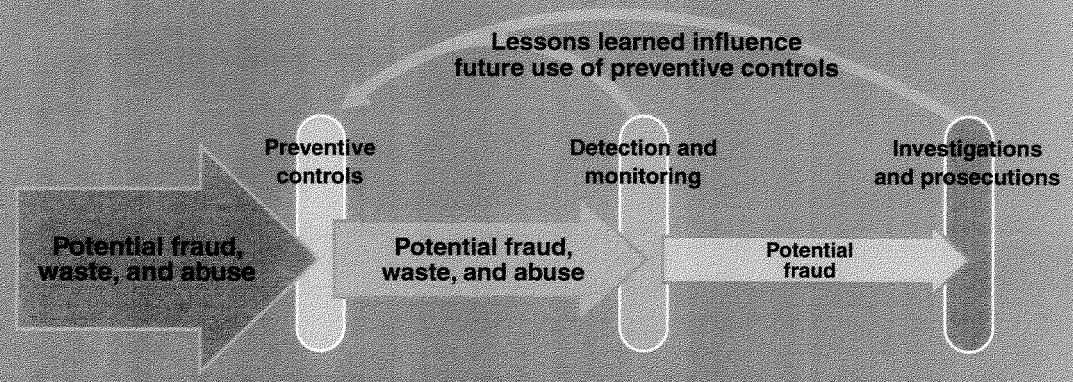
[13] Obligations made by federal agencies for new SDVOSB sole-source and set-aside contracts signed between November 20, 2009 and May 1, 2010 by the 10 case-study firms.

This is a work of the U.S. government and is not subject to copyright protection in the United States. The published product may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.

GAO's Mission	The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.
Obtaining Copies of GAO Reports and Testimony	The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday afternoon, GAO posts on its Web site newly released reports, testimony, and correspondence. To have GAO e-mail you a list of newly posted products, go to www.gao.gov and select "E-mail Updates."
Order by Phone	The price of each GAO publication reflects GAO's actual cost of production and distribution and depends on the number of pages in the publication and whether the publication is printed in color or black and white. Pricing and ordering information is posted on GAO's Web site, http://www.gao.gov/ordering.htm. Place orders by calling (202) 512-6000, toll free (866) 801-7077, or TDD (202) 512-2537. Orders may be paid for using American Express, Discover Card, MasterCard, Visa, check, or money order. Call for additional information.
To Report Fraud, Waste, and Abuse in Federal Programs	Contact: Web site: www.gao.gov/fraudnet/fraudnet.htm E-mail: fraudnet@gao.gov Automated answering system: (800) 424-5454 or (202) 512-7470
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
Public Affairs	Chuck Young, Managing Director, youngc1@gao.gov, (202) 512-4800 U.S. Government Accountability Office, 441 G Street NW, Room 7149 Washington, DC 20548

Please Print on Recycled Paper

Fraud-Prevention Model



Source: GAO.

House Committee on Small Business
Subcommittee on Contracting and Technology
"Veteran Contracting – Preventing Fraud"
May 24, 2010

Statement of Janice Cavolt
President, JBC Corp
Virginia Beach, VA

I am grateful for this opportunity to express my opinion on preventing Veteran Contacting Fraud and thankful that the government has taken notice and is proposing action to remedy the issues that impede the success and growth of **Service Disabled Veteran Owned Small Businesses.**

I am the wife of a Service Disabled Veteran. My husband Brian Cavolt, served as a Navy SEAL and Corpsman and retired after 29 years active duty service. Together we own and operate JBC Corp, a ***Service Disabled Veteran Owned Small Business***, located in Virginia Beach, Virginia. JBC Corp provides customized medical trauma kits for members of the military which are carried and used in all parts of the world.

The findings by the GAO investigation in November 2009 brought to light that ineffective fraud detection had caused ineligible firms to receive awards for contracts set aside for Service Disabled Veteran Owned Small Businesses (SDVOSB). Their findings that more than $100 million in set aside contracts (for SDVOSBS) had been awarded to 10 ineligible firms was discouraging. Unfortunately, these are not isolated occurrences, and it is imperative that action be taken to prevent further incidents.

The GAO's discovery of this fraud did not come as a complete surprise to many business owners. The tremendous competition for few opportunities cause SDVOSBs to work in the trenches where we have a peripheral view of what goes on in federal procurement. Awards to ineligible firms or not even having the opportunity to bid is one part of the problem; the other is the government's blind eye that doesn't see how poorly the contracting system is working, and the need for an overhaul.

In my opinion, the federal contracting system as it operates now, is wasteful, inefficient and rewards big business, at the expense of small business, the taxpayer and the government. It is a system riddled with rules and procedures that keep SDVOSBs and other small businesses from competing for awards; often for their own products or within their field of expertise!

Perhaps the dynamic that is most difficult to comprehend is that currently, misrepresenting yourself when doing business with the government carries no penalty. In fact, after the GAO found four of the firms in their study to be ineligible, contracting agencies allowed those contracts to proceed anyway. The awards, regardless of ineligibility, under the Federal Acquisition Regulations (FARS) allow a contracting officer to allowcontinuation of performance if a valid contract still exists. In other words, obtaining an award under false pretenses does not invalidate the contract. It is

encouraging to know that the Chairman of this Subcommittee, Congressman Glen Nye is taking action to introduce legislation to address this issue and criminalize this behavior.

During recent testimony to the Veterans' Affairs Subcommittee on Economic Opportunity, Joseph Sharpe from the American Legion offered the Legion's opinion whereby "the VA and SBA (should) develop a comprehensive partnership to assist veterans who are interested in participating in Federal procurement, with each Department utilizing their resources to ensure proper implementation".[1] Mr. Sharpe points out that the Center for Veteran Enterprise (CVE), a program of the VA, currently maintains the Veteran Information Pages (VIP) database. The VIP database has established itself as the premier database for veterans in the country and is the only federal database focusing strictly on Veteran businesses. Under this recommendation, the VA (CVE) should maintain the database (VIP) and verify accurate veteran and Service Disabled Veteran Status, and the SBA should retain the responsibility for validating the business ownership, size standards, and structural integrity of the business.

I believe the ability of these two agencies to share accurate information that is accessible for verification would be the greatest step in addressing the problem of fraudulent representation. However, I believe that we must go a step further by instituting enforcement at the procurement level. Contracting Officers should be required to verify the status and eligibility of every bidder on any set aside solicitation. Proposals from those who do not qualify should be immediately removed from consideration. Misrepresentation should be reported to the SBA so that appropriate remedial action is taken.

In summary, I believe the approach to the problem needs to be two-fold. *First*, verification and validation in accordance with the guidelines recommended by American Legion; and *second*, there must be enforcement at the point of entry (i.e. the submission of the bid).

It is important to recognize the two separate parts of this problem. To not segregate the two processes would be like asking the U.S. Department of State to be accountable for someone who is using a fake passport as identification to get through security at the airport. The burden should be on the party granting access, not the agency granting legal passports.

In conclusion, the need to protect business opportunities for SDVOSB's is critical to ensure the success and growth of their businesses. Although establishing a check and balance system will cause an extra step to be taken by SDVOSBs, it is the only way that set aside solicitations can be protected. However, having said that, caution must be exercised when implementing the solution. It is important that the processes adapted to

---

[1] *U.S. Department of Veterans' Affairs' Center for Veteran Enterprise*; Hearing before the Subcommittee on Economic Affairs, House Committee on Veterans' Affairs, 111th Congress, 2nd session, (March 11, 2010), (statement of Joseph C. Sharpe, Director, Economic Division, American Legion)

protect Service Disabled Veteran contracting opportunities do not become obstacles that get in the way of Veterans doing business. Instead, let's make it difficult for the ineligible businesses to compete. Remember, the veterans who go through a process of validation are not the ones breaking the rules.

Thank you for the opportunity to address this committee about this important issue. We SDVOSBs are fortunate to have many good minds working on this problem. The testimony given by Mr. Joseph Sharpe on behalf of the American Legion that I mentioned is referenced here and I would I urge the committee and everyone in this room to read the complete statement submitted.

Testimony for House Congressional Small Business
Committee- Sub-Committee for Contracting & Technology
May 24th, 2010 – Submitted by Cindy M. Walters

I would first like to thank Chairman Nye and the Committee for undertaking this investigation and conducting these hearings on behalf of the citizens and Veteran and Service Disabled Veteran Owned Small Businesses. What the GAO report uncovered most importantly in its findings was the unacceptable and criminal behavior of those who would opportunistically take advantage of Service Disabled Veterans and programs legislated specifically to assist them in achieving procurement opportunities with the federal government. In that also is the defrauding of the taxpayer.

I do not know the complexities of each of the specific cases, findings, and subsequent audits, but those persons who egreously have violated the law, should be punished accordingly to the appropriate statues.

As long as there are procurement set-aside programs, whether they be small business, minority, 8(a), veteran, SDVOSB, HubZone, or women owned business programs with money to be gained; there will always be those determined to "game " the system. Even in the most heavily certified and managed business development/procurement program, the SBA 8(a) program, there are still cases of fraud. The HubZone set-aside program has undergone some rigorous oversight to improve the certification validation process, but SBA requires increased resources to do physical site inspections. It is a daunting task for SBA. Having been affiliated as a working resource partner with the SBA's Richmond District office for many years, I must say they are very dedicated to assisting the Veteran Business Community. As each federal agency strives diligently to meet its small business procurement goals and change those red blocks to green on the SBA's scorecard - billions more dollars will be awarded in federal contracts to small business through set-asides. We should brace ourselves for continued interest by criminally minded persons in creating companies to gather these unto themselves.

I have been associated with these programs for the majority of my career, in some form, assisting businesses and the government, to create compliant, successful, federal contracting industry partners. I work directly, on an almost daily basis, with Veteran and Service Disabled Veteran Owned Small Business Owners. Their questions about government procurement and specifically their ability to access acquisitions set-aside for them are many and varied and illustrate some of the complexities that misused by non-veterans and those unscrupulous folks, make the veteran and SDVOSB, vulnerable. Eligibility issues come up frequently such as the following: I have a service connected disability, but have no letter from VA; I have a letter from VA, but do not own the majority in my company; I am eligible but do not have the capital or past performance to compete and I have another company who wants to team or joint venture with me. These are the scenarios in which a veteran can become caught up unintentionally in what may turn out to be a fraudulently executed/awarded federal contract. In these instances the veteran may also be the victim as well as the government. Then on the other hand, we have the issue where no veteran was involved and the entirety of the process was set up to defraud.

So, how do we mitigate the fraud? We cannot change the nature of peoples' characters, and history in other set-aside programs tells us that we will never completely eradicate the fraud; only reduce its rate of occurrence. Getting the procurement opportunities and dollars into the right hands is the key goal.

I am not a proponent of another large scale certification process, management and policing program to add to the very full basket of the SBA, who are already doing a fine job but are stretched to the limit on their resources. I would suggest that we can have a positive impact on the set-aside program for our veterans by perhaps implementing some of these changes; some legislatively and some culturally.

1) Those persons and firms who are not veterans and fraudulently claim to be so when preparing their Certs & Reps for federal contracting, when found to be doing so (by any notification or source) should be debarred and criminally prosecuted. Most likely these persons have intentionally "gamed" several other government programs such as those for minorities or women, and may also be preying on veteran owned businesses as well. These persons/firms may not be new to federal contracting and have in many cases fraudulently worked the system for years. For those firms/persons that certify themselves as SDVOSB, but in fact are just veterans, they should be referred to an appropriate agency like CVE for training, counseling, and investigation.
2) The federal contracting workforce should always use its authority to request a pre-award survey be conducted for each Veteran/SDVOSB set-aside award. In the process this is where truly the rubber meets the road. They should use DCAA and DCMA as needed to conduct reviews of control and management documentation to include eligibility letters, organizing documents, stock ledgers, etc. to ensure before award that the firm is owned and controlled by that member. Because the federal buyer does rely on the Certs and Reps, it is imperative that information provided can be documented. Unlike the small business set-asides that are often only reviewed when a protest by another firm is launched, the SDVOSB set-aside program is smaller with a smaller goal and is not used as often - so exposure to the business community as a whole would not generate the constant level of attention that the small business set-aside gets in terms of other firms protesting.
3) Recognize and respect the skills that the Veteran business community has in terms of policing their own. Veterans/Service Disabled Veterans talk about their service, their tours of duty, their deployments, others they have served with, and as my father, a career marine, used to say, "who they chewed the same dirt with." As a veteran myself, I understand this communion and can sense other veterans. When a Veteran Business Owner tells someone, whether it is the PTAC counselor, the SBDC, the DOD Procurement Specialist, the CVE, or VA or another in this vast network of "boots on the ground" resources - that another firm is identifying themselves as being veteran or SDVOB, and that firm is not, we must listen and do something about it. Whether it is during the federal proposal process, or months or years after award, we must all communicate it through our channels and act to have it investigated by the cognizant authority. Having a simple form posted on the

SBA website so that resource partners can report this information and share it with others would be very helpful.

4) Last, but not least, utilizing our great network of federal and federally funded resources as previously mentioned to include the acquisition workforce – we must continue to educate the veteran community, new to business and new to federal contracting or those in need of our help, on how to be eligible, compliant, and successful. Finding appropriate mentorship firms for teaming with our veterans, as well as encouraging the veterans participation in the programs designed specifically for them will not only foster their business acumen, but will add even more visibly to the program to help reduce the cases of fraud. I believe any visibility; inclusive of these hearings, will be a deterrent to those who seek to steal these opportunities from Veterans and Service Disabled Veterans.

In closing, I would like to say that I feel fortunate to be able to have a continued career of service focused on the Small Business Community in Hampton Roads, especially here now at Old Dominion University where President John Broderick has made this type of assistance to the business community, a central focal point of his vision for the University. He demonstrated this most recently in the opening last week of the Old Dominion University Business Gateway which houses among its many fine programs, the newly selected Veterans Business Outreach Center for Federal Region III. Hampton Roads is host to the largest community of veterans in the country and ODU has a long history of partnership with the military.

Thank you again for allowing me this opportunity to share my perspective, and to advocate on behalf of the Veteran/Service Disabled Veteran Owned Business Community.

TESTIMONY OF
Mr. Elton E. Roller Jr.
President, Greenland Enterprises, Inc.
Small Business Contracting and Technology Subcommittee
Monday, May 24, 2010

Chairman Nye, distinguished members of this Committee, it's an honor to speak on behalf of veteran business owners about ways we can work together to strengthen the SDVOSB procurement program and ways of preventing fraud.

As a small business owner and nine year veteran of the US Air Force, I am proud that our Federal Government has found ways to keep veterans serving through entrepreneurial opportunities. It's no secret that veteran business owners share a fierce allegiance to fellow veterans and often extend employment opportunities ahead of their needs. In some cases positions are created and extended to candidates requiring significant investments in training and time. Veteran business owners view this as an inherent duty to those who have served; simply said, veterans hire veterans. Procurement strategies like SDVOSB "set asides" effectively ensure that veteran entrepreneurs continue this culture of offering opportunities, hiring, training, and growing the next group of veteran business owners.

Recently, tough economic times and the promise of winning government contracts has taken those opportunities from veterans and placed them in the hands of fraudulent businesses. As most of you know, a recent GAO report sampled 10 SDVOSBs and found all ten lacking the requirements to be eligible to participate in the program. This ignorance of the law and worst case example of fraudulent activity can be attributed to several factors including the lack of private sector opportunity, oversight of the program by any one agency, and most importantly an absence of significant financial or criminal penalties.

Background

After serving my Country and working for two large HVAC manufacturers, my entrepreneurial passion could only be satisfied by going out on my own. With the unwavering support of my family, my partner and I established Greenland Enterprises, Inc. in February of 2008. Our business became a CVE (Center for Veteran Enterprises) verified, SDVOSB in July 2008. From the onset we knew that any business venture comes with inherent risk, but coupled with the worst economic decline since the Great Depression, an uncertain economic future, dwindling equity in personal assets, and a banking industry on-hold - we were especially anxious. Fortunately for us luck, prayers, and experience prevailed as we were awarded several private projects and our first Federal (SDVOSB "set aside") contract at the Richmond VAMC in September 2008.

Challenges

From those anxious moments in 2008, Greenland Enterprises has experienced steady growth fueled primarily through federal procurements under the SDVOSB program. Those opportunities have allowed us to establish deep roots in the local and regional

marketplace. They have also allowed us to hire veterans both as employees and subcontractors and they have enabled us to give back to the veteran community.

The same SDVOSB program that allows a well managed, small disabled veteran owned business with good core values to become a success story, also serves as a haven for fraudulent businesses with poor decision making to take advantage. We experienced this first hand in 2009 when a number commercial contracting firms flooded the SDVOSB program with shell companies masquerading as small, SDV owned and controlled businesses. In our particular instance, evidence presented to a contracting officer at the time of award, clearly established affiliation between the awarded SDV company and a large business, both having common ownership. Our complaint was summarily dismissed by the Contracting Officer and we were referred to an Area SBA representative for size determination of the alleged offender. The SBA agreed with our position, but referred the matter back to the awarding Contracting Officer. We were advised that we had the opportunity to protest the award and take on a large business to prove, what was already established as a clear and blatant affiliation between parties. With consideration of our financial position, uncertainty of getting the award, and the backlash that might ensue, we reluctantly declined.

After observing other awards made to this same contractor on other SDV set- asides I took up the matter again with the General Accounting Office (GAO) and they referred me to the Inspector General's Office of that Departmental Agency. To date, I have not received an update on my complaint, but did find satisfaction that the Director of Government Contracting (SBA) on their own accord, found that same contractor to be "other than small" in a protest on an unrelated award. Justice was eventually served, but many verified SDVs were denied opportunity through the actions of fraudulent companies.

With the lack of opportunity in the private sector more firms will continue migrate to the federal sector and with that, the potential for fraud will increase. Until the price for noncompliance outweighs the price of compliance the SBA, GAO, and lawmakers will continue to hear examples like this. We believe the tool to prevent such action has already been established with the Center for Veteran Enterprise's verification process and that the timeline for implementation, currently 2011 is not soon enough. With the verification process in place, Contracting Officers can quickly confirm the legitimacy of SDV firms thus making the process of awards more efficient. Protests of such awards will be reduced and the stigma of the GAO report and fraud in the SDV program will diminish.

Thank you for the opportunity to share the experiences of Greenland Enterprises and I would like to personally thank this committee for your commitment to veterans and small businesses. I would also take this opportunity to remind your colleagues in Congress that Small business is the life line of this country and capitalism. We must continue to foster opportunities, have an open dialogue such as this with lawmakers, and take the necessary action to put veterans and Americans back to work. Thank you for your time and dedicated service to our country.

TESTIMONY OF
Mr. George T. Armbruster, Jr.
Vice President and Business Development Director of
Fleet Services And Installation, LLC.
Small Business Contracting and Technology Subcommittee
Veteran Contracting-Preventing Fraud
Monday, May 24, 2010

Congressman Nye, distinguished members of the Committee, thank you for allowing me to speak on behalf of owners and members of service disabled veteran owned small businesses throughout the United States. This testimony will describe to the committee the challenges Service Disabled Veteran Owned Small Businesses' (SDVOSB's) are facing due to the lack of an enforceable plan and accountability for Executive Order 13360.

My business partner Duncan "Duke" N. Ingraham, Jr. and I have been business partners for the past eight years. Duke is a 1994 graduate from the United States Naval Academy. I am a 1989 graduate of Virginia Military Institute. Following Duke's graduation, he served in the US Navy as a surface warfare officer from 1994-1999. Unfortunately, Duke was medically discharged out of the US Navy due to a back injury while serving. After college, I worked and owned a business in the environmental field specializing in air emissions monitoring. Several years later, I decided to make a career change and started working for corporate America. Both

Duke and I met while employed by the same large national chemical company. We worked together for more than four years when we decided to break out on our own as entrepreneurs in 2003.

Our first company was a granite and marble importing and distribution business, Fleet Imports, LLC. We formed Fleet Imports in December of 2002 and started operations in the summer of 2003. This business was mainly geared toward supporting the residential construction industry. Over the next six years, we grew the business to three locations in Virginia and North Carolina and employed 34 people. In May of 2009, Fleet Imports was honored to receive the Virginia SBA Veterans Champion Award in Richmond, Virginia for hiring the most veteran's percentage wise than any other small business in Virginia. Fleet Imports was founded on integrity and customer service and our employees exude these characteristics.

Due to the decline in the housing market, we decided to explore other opportunities. After much investigation, we decided to pursue the commercial market with the intent to continue slowly growing Fleet Imports through the recession. Fleet Services And Installation, LLC (FSI) was formed in January 2008 as a service disabled veteran owned small business.

Duke, as the service disabled veteran is the President of this new venture and owns 51% of the company and I am the V.P. and own 49%. Our intent in forming FSI was to focus on aspects of the commercial market that we knew.

In 2009, we started bidding work as a subcontractor to large general contractors working on Federal Construction Projects. We have bid over a hundred projects to larger general contractors but up to this day we have only received three subcontracts. We know that with Executive Order 13360, a 3% goal is in place for prime contracts and subcontracts for SDVOSB's.

The whole process begins when a large construction project is solicited. Several large general contractors are interested in pursuing the project. They develop a small business plan that they feel will win the favor of the contracting officer. These large businesses reach out to the small business community through fairs and take our information. Next, these general contractors ask us for a price on certain scopes of work. Then they submit their proposals to the contracting officer. During the evaluation period, a contracting officer looks over the proposal and also checks to see if a proper

small business plan has been developed and a general contractor is then selected. At this point, the general contractor finishes up their design drawings for the project. The final step is buying out the scopes of work, or subcontracting. This is where the problem occurs. The general contractors will look for the absolute lowest price when buying out the scopes with little to no regard to SDVOSB's. Once the project is completed, the general contractors have to explain to the contracting officer why they did not meet their small business goals. Time and time again, they tell the contracting officers that they gave it their" best effort" to find SDVOSB's to participate. All of these practices are allowed because there is **NO OVERSIGHT, NO ACCOUNTABILITY, NO PENALTIES, and NO PROGRAM.**

We have found that if our price is not the absolute lowest bid; we will not receive a subcontract to work on government projects. For example last year we bid on a ceramic tile subcontract for a large federal hospital near Washington, D.C. We were recommended by the general contractor to the Army Corps of Engineers. The Army Corps of Engineers decided that our price was not the absolute lowest for the ceramic tile and gave the contract to the lowest bidder. We later found out that our subcontract price was only 1% higher than the lowest bidder, a large business.

The SDVOSB set asides appear to be totally irrelevant to the contracting officers and the larger general contractors working on federal construction projects. This is because there is absolutely no oversight or accountability. As the system stands now, the SDVOSB set aside program in relation to subcontracting is an honor program which very few honor.

Another frustrating experience was when we tried to work for general contractors on foreign embassies for the US State Department Overseas Building Operation. I traveled out to Alabama to meet with the two largest general contractors priming the largest percentage of foreign embassy projects. We were interested in the natural stone cladding scopes of work. We were told by these general contractors that they purchased natural stone materials from overseas suppliers, and that they used overseas labor for the installation of the cladding. They follow these practices because of low foreign labor costs as compared to using qualified United States labor. Companies in the federal construction market are required to use the Davis Bacon Wage Scale for field labor for projects in the United States. One of the general contractors working on foreign embassies projects told me that we would have to significantly beat their current supplier and labor costs to gain their business. After our meeting, I spoke with the US State

Departments Overseas Building Operations Representative and asked if they were required to meet any SDVOSB goals. The representative informed me that since the project were overseas, the general contractor had no goal requirements for using SDVOSB's as subcontractors. This is maddening when you consider that we have 25% unemployment in the United States construction field. Tax dollars are being used on these projects without any SDVOSB participation. Foreigners are being used to install natural stone building cladding on our United States Embassies. Senator John Kerry introduced legislation "To Advance U.S. Embassy And Consulate Design" on April 16, 2010. Senator Kerry's legislation stated, "The legislation recognizes that United States embassies are important reflections of American values of openness, ingenuity, and innovation and should reflect the best of U.S. design, architecture, sustainability, and technology while maintaining security as a top priority." **Why are we denying our veteran owned small businesses the opportunity to continue to participate in the construction and security of our embassies?**

To combat the multitude of problems describe herein, other service disabled veteran small business firms that have been in the commercial business for several years have advised us to give up bidding on subcontracts. They

claim we should focus on priming jobs directly to the federal government. Our problem with this advice is that we are emerging into the commercial market with valuable experience but still need to hone our skills, build a financial base and develop bonding capacity prior to taking on a prime contract.

There are many veterans and service disabled veterans that will be entering the job market in the near future. If any of these individuals decides to pursue a career as an entrepreneur in the construction field, they will need to gain experience, financial backing and bonding capacity before they can prime a federal job on their own. Subcontracting to larger general contractors on federal projects will give veteran business owners the opportunity to develop into prime contractors. Oversight and accountability is critical in any program. Congress needs to end the facade and support the service disabled veteran entrepreneurs growing small businesses. Congress needs to require all SDVOSB firms to become certified through a program instead of the self certification to avoid fraud. Congress needs to require general contractors working on federal construction projects to provide the names of qualified SDVOSB's that they will be using upfront. The responsible contracting officers should ensure that stated goals will be met

before awarding any contract. Additionally, substantial penalties should be given in all awarded contracts for companies that do not meet required goals.

Without oversight or penalties for large general contractors working on federal projects, the practice of ignoring SDVOSB's will continue. There is no point in having set aside programs when they are ignored. A system needs to be in place which checks the validity of SDVOSB's and enforces that general contractors actually follow Executive Order 13360.

○