AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

MISREPRESENTATION AND FRAUD: BAD ACTORS IN THE SMALL BUSINESS PROCUREMENT PROGAMS

HEARING

BEFORE THE

SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT AND REGULATIONS

OF THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

HEARING HELD
OCTOBER 27, 2011

Small Business Committee Document Number 112–042
Available via the GPO Website: www.fdsys.gov

U.S. GOVERNMENT PRINTING OFFICE

74–304 WASHINGTON : 2012

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) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

CONTENTS

OPENING STATEMENTS

	Page
Coffman, Hon. Mike	1

WITNESSES

Peggy E. Gustafson, Inspector General, US Small Business Administration, Washington, DC	2
Brian Miller, Inspector General, US General Services Administration, Washington, DC	4

APPENDIX

Prepared Statements:	
Brian Miller, Inspector General, US General Services Administration, Washington, DC	14
Peggy E. Gustafson, Inspector General, US Small Business Administration, Washington, DC	19
Questions for the Record:	
Chairman Coffman Questions for Inspector General Gustafson	28
Chairman Coffman Questions for Inspector General Miller	31
Answers for the Record:	
Inspector General Gustafson Response to Chairman Coffman Questions for the Record	34
Inspector General Miller Response to Chairman Coffman Questions for the Record	44

MISREPRESENTATION AND FRAUD: BAD ACTORS IN THE SMALL BUSINESS PROCUREMENT PROGRAMS

THURSDAY, OCTOBER 27, 2011

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INVESTIGATIONS,
OVERSIGHT AND REGULATIONS,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 10:00 a.m., in Room 2360, Rayburn House Office Building. Hon. Mike Coffman (chairman of the subcommittee) presiding.

Present: Representatives Coffman and West.

Chairman COFFMAN. The federal government has a goal of awarding 23 percent of prime contract dollars to small businesses, and subzones for the HUBZone, women-owned, service-disabled veterans-owned, and small disadvantaged small businesses. Congress created these programs out of a belief that small business contracting benefits us all. Small business contracting reduces prices by encouraging competition, promotes innovation, strengthens the industrial base, and creates jobs. These programs do create real opportunities.

Last year, the small businesses won over $109 billion in prime contracts, which is about 20.3 percent of the $538 billion in prime contracts awarded last year. However, just as we all benefit from small business prime contracting, we all suffer when fraud rears its ugly head. Legitimate small businesses lose the ability to perform when contracts go to firms that did not qualify for or who are not following the rules associated with small business contracting programs. The government suffers from this fraud because bad actors give all small businesses a bad name. So contracting officers are more reluctant to use the small business programs, which in turn results in less competition and a less vibrant industrial base.

Finally, the American people suffer. Small businesses create two out of every three new jobs, so when contracts go to false small businesses, fewer jobs are created.

We are here today to learn about the depth and scope of fraud in the small business programs and how we can better ensure compliance. One need only pick up a newspaper to read about scandals in the procurement system. The Inspector General and Government Accountability Office reports enumerate the lack of controls in oversight in these programs and the reluctant—and the result

and abuse of these programs. Sadly, fraud in the small business program often seems to go unpunished and unprosecuted.

We have with us today the inspectors general from the Small Business Administration, which is charged with maintaining the integrity of the small business programs and the General Services Administration, which has contracting as its primary mission. Given their expertise, I believe they will help us understand how we can do a better job protecting opportunities for legitimate small businesses by catching and prosecuting those that seek to exploit these programs.

I now yield—well, the ranking member is not here.

[The information follows:]

STATEMENTS OF THE HONORABLE PEGGY E. GUSTAFSON, INSPECTOR GENERAL, U.S. SMALL BUSINESS ADMINISTRATION; THE HONORABLE BRIAN MILLER, INSPECTOR GENERAL, UNITED STATES SMALL BUSINESS ADMINISTRATION

Chairman COFFMAN. Let us see. What is the order? The Honorable Peggy Gustafson. Did I pronounce it right?

Ms. GUSTAFSON. It is Gustafson, Mr. Chairman.

Chairman COFFMAN. Gustafson.

Ms. GUSTAFSON. Yes, thank you.

Chairman COFFMAN. Okay, close. Who has served as SBA inspector general since October 2, 2009. She also presently serves as the Legislation Committee chair for the Council of Inspectors General on Integrity and Efficiency and is a member of CIGIE, again, the Council of Inspectors General on Integrity and Efficiency, the Executive Council. Inspector General Gustafson—get it closer?——

Ms. GUSTAFSON. Yes.

Chairman COFFMAN [continuing]. Has considerable experience rooting out fraud, waste, and abuse, having served as general counsel in the Missouri State Auditor's Office as an assistant prosecuting attorney for Jackson County, Missouri; as chair of the Insurance Fraud Task Force; and as an assistant county counselor for Jackson County. Ms. Gustafson.

STATEMENT OF PEGGY E. GUSTAFSON

Ms. GUSTAFSON. Thank you, Chairman Coffman. Thank you very much. And thank you for the opportunity to be here today and for your continued support of the work of my office. I am proud to represent the dedicated men and women of the Small Business Administration Office of Inspector General.

SBA plays a crucial role in ensuring that small businesses gain access to federal contracting opportunities. The agency is responsible for ensuring that the government-wide goal for participation of small business concerns is established annually and for reporting the agency's achievements relative to that goal. As you know, the current goal for the federal government is that 23 percent of prime contract dollars be awarded to small businesses.

My office's reviews continue to identify procurement flaws that allow large firms to obtain small business awards. In fact, this issue is identified by my office as a top management challenge for the agency and has been for several years. Our audits and other studies have shown significant misreporting by procuring agencies

with many contract awards reported as going to small firms while actually being performed by larger companies. The SBA itself is not immune from such activity.

My written statement provides a summary account of a significant sole source 8(a) IT contract that was awarded by SBA to a small business but which basically served as a pass-through to buy the products of large businesses. The audit found that SBA did not adequately plan the procurement, they split the procurement to circumvent sole source limits, inaccurately reported the contract data to FPDS (Federal Procurement Data System), and awarded the contract on a sole source basis even though it did not qualify as an 8(a) procurement to be ordered sole source.

These misrepresentations I think should not be viewed as insignificant occurrences because our work continues to show that these signs are often the tip of the iceberg.

Several weeks ago an investigation conducted by my office with several interagency partners, including the FBI, resulted in the arrest of four individuals. These individuals have been implicated in what has been described by Department of Justice officials as one of the most brazen corruption schemes in the history of federal contracting. This investigation actually began as an investigation into another business' misrepresentation of HUBZone status and of being a service-disabled veteran-owned small business, and it led to the discovery of an alleged bribery, kickback, and money laundering scheme that has resulted in the arrests of two U.S. Army Corps of Engineers and two co-conspirators on October 4th of this month. They have been charged in an indictment that accuses them of taking part in a conspiracy involving at least $20 million in bribes and kickback payments and the planned steering of a $780 million government contract to a favored contractor who participates in the 8(a) program.

The indictment details schemes to defraud two major federal contracts which have a combined value of about $1.78 billion. The first contract is a U.S. Army Corps of Engineers TIGER contract, which is what is known as an indefinitely quantity—pardon me—indefinite delivery, indefinite quantity contract, which I will call IDIQ from now on because it is easier. Over the five-year term the total award of orders placed against this TIGER contract is authorized to exceed a billion dollars. EyakTek, an Alaska Native-owned small business based in Dulles, Virginia, was the prime contract for the TIGER contract and subcontracted many of the orders from this to other businesses.

The other contract in this scheme is called the CORES contract, and it was envisioned as an alternative or potential replacement for the TIGER contract. The CORES contract, had it gone through, would have been a five-year contract with a task order ceiling of $780 million. The indictment alleges that the four defendants worked with a chief technology officer of a company known as Company A, which is also an 8(a) firm, to devise a scheme to steer the award of this CORES contract to Company A. The intent was to use this contract as a way for Company A to funnel federal money and other things of value directly and indirectly to the defendants and other co-conspirators. Although the investigation is ongoing, the arrests to date have effectively dismantled the group respon-

sible for perpetuating this fraud against American taxpayers. And my understanding is actions to seek appropriate suspension or debarment for the parties responsible for this conspiracy are underway.

I want to assure you that my office intends to join our partners and evaluate the internal controls and regulations involved in the contracts that are at issue here and make any necessary recommendations to our agencies or to Congress to prevent such fraud schemes from being successful in the future.

Again, thank you very much for inviting me to speak with you today, and I am looking forward to your questions.

[The statement of Ms. Gustafson follows:]

Chairman COFFMAN. Thank you. Our second witness is The Honorable Brian Miller, who has served as the General Services Administration' s Inspector General since 2005. He previously spent 15 years with the Department of Justice, including time as the Assistant U.S. Attorney for the Eastern District of Virginia, where he had considerable experience with procurement and grant fraud. Mr. Miller has received notable recognition for his service as inspector general, having been recognized by—okay, there we go—Ethisphere Magazine, as the 12th Most Influential Personal in Business Ethics by a worldwide panel of experts.

I want to thank you both for being here today. Mr. Miller, go ahead with your testimony, please.

STATEMENT OF BRIAN MILLER

Mr. MILLER. Thank you, Mr. Chairman.

Good morning, Chairman Coffman and distinguished members. Thank you for inviting me here to testify this morning.

Let me acknowledge from the outset that I am not an expert in small business matters, but my office plays a role in investigating small business fraud in the programs administrated by the General Services Administration.

From our investigations we have seen two major types of schemes to obtain small business contracts. First, individuals falsely claim to meet small business eligibility requirements, such as size. Second, they fraudulently use an eligible small business as a pass-through or front so that an ineligible company can perform the work and collect most of the taxpayer dollars, usually kicking back a small percentage to the eligible small business.

My office is currently investigating a case jointly with the IG from the Small Business Administration and the IG from the Veterans Administration. The indictment alleges that the defendants made false statements to meet service-disabled veteran-owned small business eligibility requirements. The defendants obtained more than $6 million in federal contracts as a service-disabled veteran small business. When the VA began to verify self-certifications, the defendant allegedly created and submitted documents that said that the veteran completed three tours in Vietnam and received numerous medals and citations. But according to federal records, the individual was never classified as a service-disabled veteran and was honorably discharged in 1968 after serving as an engineer mechanic for five years in the National Guard during which time he never left the state on active duty.

This kind of fraud derails small business programs. Unfortunately, it is not always possible to find a civil or criminal remedy. Prosecutors usually look to loss to the United States. When the government has received goods and services, even from an ineligible company, it is very difficult to prove a monetary loss to the government. After all, the government did receive goods and services and an adequate product. But there is real loss and real damage to the integrity of the small business programs and lost opportunities underlying those programs, starting with the legitimate small business that did not get the contract.

This harms small businesses and it harms all of us because small businesses create jobs. Almost two out of every three new jobs are created by small businesses. Because fraudulent self-certifications are difficult to detect, dishonest companies expect to get away with it. And so a strong penalty is needed to deter those who might be tempted to falsely self-certify. The greater the temptation to commit a crime and the smaller the chance of detection, the more severe the penalty must be. A strong penalty will take the profit out of crime, which is an idea behind our forfeiture laws and our fraud laws.

The Small Business Jobs Act requires the Small Business Administration to issue regulations that protect innocent individuals and small businesses from liability in cases of unintentional errors, technical malfunctions, and other blunders. We believe this is very important. Given the complexities of many of the rules governing eligibility for preferential contracting programs, companies should not be punished for innocent mistakes. Our experience, however, has shown that we need a significant penalty to deter companies that might willfully misrepresent their status in order to obtain federal contracts intended for true small businesses.

Thank you for inviting me here this morning. I would be pleased to answer any questions. Thank you.

[The statement of Mr. Miller follows:]

Chairman COFFMAN. I want to thank you both again for coming today. Let me just start out that when a small business presents itself in terms of being eligible for one of these categories like you just mentioned, disabled veterans, is there a vetting process whereby the—whether it is GSA or the respective government agency checks this information out? Because I know, for instance, a DE214 is very easy to forge. And so is there some corresponding communication with the Veterans Administration, Department of Defense or whatever to see whether the information is accurate in terms of eligibility, Mr. Miller and then Ms. Gustafson?

Mr. MILLER. Well, generally in the federal government, the federal government tends to rely on self-certifications. In the General Services Administration, for example, we rely a lot on self-certification by vendors and contractors. And unfortunately, many times those self-certifications are not accurate. We did a survey recently, our Forensic Auditing Unit looked at self-certifications of products that were listed on a GSA schedule that claimed to be environmentally friendly. They had a green seal certificate. Well, we checked with the certifying company or organization and we found out that 84 percent of those self-certifications were inaccurate. And so we let GSA know. They are taking steps to correct it. They are

going to try and get the certifications directly from the organization.

But unfortunately, the federal government does not have—we do have limited resources and it is hard to check all the self-certifications. In the case of the service-disabled veteran, the veteran-owned small business, the government does rely on self-certifications but the Veterans Administration started to verify those self-certifications. And when they went to verify it they did catch some misrepresentations, including the one I mentioned in my opening statement. But unfortunately, when we are dealing with dishonest individuals and companies, when the federal government—whether it is VA or SBA or GSA—when they go back and try and verify, a dishonest individual or company may submit phony documents as this company did in the case I mentioned. They phonied—well, allegedly phonied documents relating to tours in Vietnam and medals received and the like.

Chairman COFFMAN. Ms. Gustafson.

Ms. GUSTAFSON. Yeah. I think one of the difficulties for even an honest small businessman, quite frankly, when it comes to the programs that SBA administers is, you know, you have four major programs. You have the 8(a), women-owned, service-disabled veteran, HUBZone. Each one is a different process to get into the program. Each one has a different level of vetting being done by the government before you are actually allowed to say I am an 8(a) firm, I am a women-owned small business firm. I will tell you that in general the trend is the older the program—for example, 8(a) which has been around a long time—it generally seems to be harder to get in if you are not honest with that program because the government does do a more stringent kind of review of this stuff that you are presenting before they say yes, you can certify as an 8(a). And it kind of is a downward trend to the women-owned small business program, which is the newest iteration of that program where one of the things you can do is submit to a third-party depository the documents that you believe would certify you as a women-owned small business. Or you could give a pile of documents to a contracting officer who would then have to kind of do the vetting and see if really you are accurate.

And I guess I would suggest to you that that is a very complicated system. And I think it has been found especially through the GAO reports. There have been, of course, a series of GAO reports about these programs, not women-owned but the other programs.

Again, in general, it has been found to be—it is easier to get into the programs, as Mr. Miller said, with the self-certifications where really the government is relying on the businesses to say yes, I am in a HUBZone. Yes, I am trying to keep as many employees in the HUBZone as is required. I think that they tend to be easier to get into and are harder to detect than the programs where the government had a greater role. But it is a very complicated system.

And I would add that I do, as the inspector general for the Small Business Administration, we certainly think that we, as a government, can do a better job of the vetting and provide better training both to the procuring agencies and to the agencies and to the gatekeepers to make sure that they understand these rules, are doing

the vetting, and are referring the bad actors for criminal prosecution. I think there is definitely more than can be done.

Chairman COFFMAN. Well, let me refer this time to Mr. West from Florida.

Mr. WEST. Thank you, Mr. Chairman. Thank you both for being here today.

I am really concerned about the veterans' thing, being a veteran myself and the district that I represent down in South Florida having a lot of veterans. You know, we had the recent decision out of the Circuit Court of California where the Stolen Valor Act was deemed within someone's First Amendment rights to go out and wear whatever medals and things of that that they wish. And so I think that there is this pervasive atmosphere out there of people being able to masquerade as veterans and use this program.

So my concern is you talked about how you work with the Veterans Administration. Are there other databases that you could use that help you? Because, you know, self-certification, as the chairman brought up, DD214 is very easy to forget and we see that lots of times. Even, you know, the retired ID cards are very easy to forge. Are there other databases other than the VA that you could use to assist you?

Mr. MILLER. There are other databases that we do use regularly. We have a number of databases in the General Services Administration that we check regularly and we will check against records from other agencies against those databases, too.

Mr. WEST. Do you flag someone? I mean, you know, even if there is not, you know, an immediate penalty or criminal prosecution, is there a means by which you can flag someone so that if they are trying to do this in Georgia then the next thing you know they move and they try to do it in South Carolina, North Carolina?

Mr. MILLER. There is. And, in fact, I have developed an interactive map of the United States with the databases of debarred contractors for each state. Now, we do not have links to every state because states differ in whether they have a consolidated database for debarred contractors or whether they are organized by city. But we have links to the states that we can have links to. And we do have one for Georgia.

If you go on the map, and we have it up on our website. If you go on the map you can click on Georgia, for example, and that will link you into the state debarment database. And I have been pushing this for a number of years because we have come across cases where contractors have been debarred in, for example, a highway guardrail company was debarred in the state of New Jersey in 2005 for making defective guardrails, something that is pretty important. After it was debarred in New Jersey, the state of Delaware entered into contracts with that company, and then the federal government entered into contracts in Pennsylvania with the same company. We caught up with them and in 2007 the CEO and the company pled guilty to wire fraud. And even then it took us a year to get them on the excluded parties list for the federal database—debarment database. So after we came across that case we developed this interactive map and we tried to make it known to as many people as we can, including city officials in Atlanta, because we had investigated a case in California where a couple of individ-

uals were selling defective counterfeit smoke alarms. And they would get a piece of tape and say certified by Underwriters Laboratory and put it on the back. GSA bought about 20,000 of these. They were debarred. They were caught, convicted, debarred. Sometime after that but before they went into the federal prison system they sold 15,000 to the Atlanta Fire Department, and they gave them out to disadvantaged neighborhoods to have smoke alarms and they did not work. They had to do the recall. And I understand now they have changed the procurement law for the City of Atlanta to require them to check the federal department database and they do have our interactive map as well. So checking database is a very important—I am sorry to go on about that.

Mr. WEST. Well, you bring up another—if I may have a little more time. What is the gamut, the minimum-maximum of penalty or punishment? I mean, that is an impotent deterrent. So, I mean, when people come in and let us say I am coming in to apply for a service-disabled veteran-owned small business, does someone tell me right up front, you know, if you are found out to be defrauding the government this is the minimum you can receive? Maximum that you can receive?

Ms. GUSTAFSON. I will give Inspector General Miller a break and I will try to address your question.

There is no question. When you are trying to enter a government program and you are making affirmative statements that if true were to allow you to be in the program, you are certainly certifying to the accuracy of that and subjecting yourself to federal and civil penalties. I believe that there is verbiage to some extent on the forms that, you know, like a normal legal firm I hereby affirm and, you know, know that I could be subject to these penalties.

But I want to emphasize a couple of things that are very important I think for this system to work. One is that those penalties have to be used. And actually, to Inspector General Miller's point, his work on the databases and information sharing is great, but to your point, Representative West, first you have to have somebody on those lists, which is to say you have to have taken the step to suspend them, for example. It is not enough to just—one of the things that concerns me about—both, as was just mentioned, how once the government started looking closer a lot of people just left the program. A lot of businesses just dropped out. The same thing happened with the HUBZone program when there was something of a scandal when GAO did some very scathing reports about ineligible firms getting HUBZone contracts. When SBA started doing a very thorough review and seeing if everybody belonged in the program, people dropped out in droves and that is great but unless—they may have gotten contracts already under that and unless—and this would be very time intensive—unless we have gone back and seen that that has happened and then taken action against them, if they are going now and they are in a different program or if they were working with the federal government, dropped out, and now are trying to do business with Alabama but it was enough that they just dropped out, nobody is going to know that.

So I think that one of the things that I know that both of us spoke about in our written statement is the importance of suspension and debarment as a tool. I will tell you that I think it is gen-

erally—genuinely or generally acknowledge by all the IGs that the federal government does not use that tool nearly enough. And to your point, it is a very strong tool to use because if you hit a bad actor in his pocketbook, that is going to have an effect. And if the procuring—if the bad actors in general know the federal government is going after bad actors, that is going to have a deterrent effect as well. But if you are not doing that, it is not. It becomes a cost——

Mr. WEST. It is Pavlovian.

Ms. GUSTAFSON. It is a cost of doing business and an unlikely one at that. And that is very problematic.

Mr. WEST. Thank you, Mr. Chairman. I yield back.

Chairman COFFMAN. If you have—I will come back to you if you have any additional questions.

So is part of the problem the way that these programs are structured? So you take HUBZone. So you have to have some presence in a HUBZone. And then the question is, is it somewhat ambiguous as to what that, you know, where is the line between fraud versus a legitimate presence? You know, and I know on some of the minority contracting, you know, you have a firm that is kind of a front and they are really operating for others. But is the line somewhat hard to draw in those instances as to what is legitimate and what is fraudulent?

Ms. GUSTAFSON. It is incredibly difficult to draw. HUBZone is an excellent example because you do have that—you are dealing with a physical location and you have literally—you just have to have an intent to have 35 percent of your employees living in that HUBZone. First off, that is difficult—do you tell the employees not to move? I mean, you cannot do that anyway. And then how would you prove a business owner did not have the intent to keep a 35 presence? That is an incredibly difficult standard.

And I will tell you that a lot of the referrals that we had gotten from GAO after their reports about these HUBZone issues, they were declined criminally for that very reason. I honestly, as a former prosecutor, do not know how you go in and prove that beyond a reasonable doubt. I just do not know how you do it.

I think that—but it also must be acknowledged that the very nature of these programs I think argue against very simple rules. I think it would be hard to draw incredibly simple rules because you get into who controls the company and that is important to know because you should have—in an 8(a) program you should have the disadvantaged individual controlling the company. And when those are kind of prerequisites to the program, it is hard not to have to a certain extent convoluted rules but there is no question that they are difficult. And the more difficult it is for the agency to administer, then try explaining that again to a jury. It is hard to do.

And it is one of the reasons, though not the only reason, I think, that we very often have a frustrating time getting cases accepted. The "no loss" provision that Inspector General Miller talked about is the biggest reason, just so you know, that I would love to discuss, but just the complexity of these programs, again, for the small businesses to understand, for the contracting officers to understand, for the AUSAs to understand is considerable.

Chairman COFFMAN. Mr. Miller.

Mr. MILLER. And these are very difficult cases to prove. That is why prosecutors do not like them generally. You know, when you talk about an 8(a) company and a minority doing 51 percent of the work, it is very hard to prove that they were doing less than 51 percent of the work. But it is very important to go after the cases where you can prove it, to send the message, the deterrent message, to stop others from trying to cheat because they know, as I said in my opening statement, they know that they may not be detected, that the federal government may not be able to make the case against them easily, and they may get away with it. So it is important to make a statement with the ones that we do catch and make sure the penalty is high enough to send a statement. And that is where the measurement of the loss to the government comes in because the sentencing guidelines are geared to loss to the government. And if there is a very small loss what a judge might do is say, well, the federal government got most of what it asked for. Sure, it did not get it from the small business, but it got a pretty good product. And, you know, I had a case where the product was actually better than if it were done by a small business. But that is why as a substantive rule of law, if we say that loss to the government equals the value of the contract, then the amount of loss is higher and the potential sentence is higher. And the same with civil cases, too; cases under the False Claims Act, for example. If you have a higher loss to the government, you have potentially trouble damages and civil penalties. And then it would be worthwhile to bring the cases.

Chairman COFFMAN. So review with me, both of you, what your recommendation in law in terms of the penalties.

Ms. GUSTAFSON. I think the main recommendation that we would both talk about in that was part of a white paper produced by the National Procurement Fraud Task Force and has been suggested before is defining what a loss is. I mean, if you tell—if you say in law if you are a dishonest actor who should not have gotten this 8(a) contract and this was a $20 million contract, that is now a $20 million loss to the government because the government has lost the benefit of awarding that contract to somebody that they were meaning to help by awarding the contract. Some valid 8(a) firm out there lost the ability to have a $20 million contract with the government because it was awarded to somebody who had committed fraud to get there. If that is the loss, then they are facing jail time, serious time. And that is what gets the prosecutors interested.

And right now that is not the loss because we got our widgets. You know, the government got what they bargained for and that, most often, and certainly in the cases we are talking about, the government got the products. And so the government, right now the way the law is, the government is not out that money. That is not a loss. But I would argue that it is a loss because then why have the program? I mean, the whole point of the program is to give it to a legitimate firm. So.

Mr. MILLER. This is something that I have been recommending for a number of years. In 2007, I wrote the white paper for the National Procurement Fraud Task Force and that was one of the recommendations. I would also recommend that it apply not only to

the criminal context but also to the civil context, to the False Claims Act in particular and also to what they call the Mini False Claims Act, the Program Fraud Civil Remedies Act (PFCRA). And that way we would have more effective civil remedies as well.

Chairman COFFMAN. There is one question I have to ask you, and that is sometimes I get complaints from the Federal Judiciary about the overcriminalization, you know, that it is stacking up in their courts. So if we went to the system that you are recommending, what kind of caseload do you think would be added to our federal court system?

Ms. GUSTAFSON. I think I would be living in a fantasy world if I thought that they would be knocking down my door for every case that I could give them, in all candor, which is to say I doubt that we would then displace every kind of juicy drug case or kidnapping case or anything that the feds are dealing with now. But I cannot give a quantitative answer to that question but I can tell you that we would be effectively able to go after people who are illegitimately getting contracts worth tens of millions of dollars. And I think that that is something that is important to the federal government and should be. And then obviously, no prosecutor has to take any case. No U.S. attorney has to take any case. I still think it becomes—obviously, they still have complete discretion on what to take. But I think it would give greater visibility and attention to these cases.

And I think especially now, though I think it is always important, but especially now when we are trying to find every dime that we can in savings and trying to do the most that we can with the money that we have, it is important that the federal government have integrity in these programs or we are really throwing money away. We may as well just have full and open competition which may get us a better price but I do not think small businesses always do as well in that. I mean, I really think if we are trying to help small businesses these programs have to have integrity and the bad actors have to be gotten out of these programs.

Chairman COFFMAN. Mr. Miller.

Mr. MILLER. It would increase the criminal cases but not a whole lot because they are still difficult to prove.

On the civil side, I think the cases would increase because you would have more False Claims Act cases because currently it is not worthwhile for a relator or whistleblower to go into federal court because the small business will fold or they will not get enough in damages.

Chairman COFFMAN. Okay. Out of the different categories in small business contracting, the different preferences, which one do you think is the most abused in terms of fraud?

Ms. GUSTAFSON. There is absolutely no way I could give you an answer to that question because I would have to know the universe of fraud and my 31 investigators could not possibly tell that. I mean, you have relative sizes of programs but I could not tell you which is the most abused.

Chairman COFFMAN. Is it HUBZone? Is it minority contracting? Is it——

Ms. GUSTAFSON. I would say it is just abuse of a different type depending on the program.

Chairman COFFMAN. Okay.

Mr. MILLER. It is a bit of a catch-22 because right now, unfortunately, we do not devote huge resources to detecting small business fraud. We do investigate it and try and detect it. But we devote our limited resources to the larger cases. For example, we recovered $200 million about two weeks ago from Oracle. And so we devote resources to huge cases and we do devote resources to the small business fraud cases but not a lot because we know if we develop them and spend the resources, they are likely not going to be accepted for prosecution. There is likely not going to be a False Claims Act case brought by the Department of Justice, and here we have spent all these resources for very little return. And I do not think you would be happy with us, for using our resources in that way. So it is kind of hard to say which program has the most fraud. Once we start looking I will guarantee you we will find fraud because I think it is fraught with fraud, especially when you rely on self-certifications without verification.

Chairman COFFMAN. And final question because I have to go vote, and that is what about—do you think that it is just prohibitively costly to put more of a responsibility on the part of the acquisition force of government to vet these applications? To vet the bids a little bit better? To say, okay, is this really a disabled veteran? Is this really a minority firm? Is this really going to be in the HUBZone? I mean, is there more—should there be more responsibility in terms of contracting?

Ms. GUSTAFSON. I am not sure that the answer is putting a greater onus on the acquisition workforce to your point that they are already really overburdened. And quite frankly, I will tell you from where I sit what concerns me about that is the contracting officers have a job to do. They need to get those contracts done. They need to meet their goals. They need to be swift about it. And I worry about then saying and then, by the way, make sure these small business programs are working well. I am not sure that that ever gets to be their highest priority. I do not think that they should be expected to know the ins and outs of the programs. I think it needs to be—I think the government needs to engage in a very robust discussion about where that responsibility lies.

I will tell you that one of the things that worries me is I think right now procuring agencies in the Small Business Administration are not always clear on who is supposed to be minding the store, especially when it comes, for example, to the 8(a) program just as far as who is supposed to be looking at the limitations on subcontracting and what is going on. I think that that is a discussion that needs to be had within the executive branch and perhaps with guidance from Congress, and we make it clear what the roles are. I think if we make it clear whose role is what, and I think if we make sure that they are adequately trained, which is not happening right now certainly in the acquisition workforce, we do a better job. And that, along with, you know, there is a whole protest. You know, businesses who lose out protest and it is amazing how much we learn from that because they know. I mean, so the system is there. I think we just need to be better about it, better trained about it, and make it clear who is expected to do it because to Mr. Miller's point, these procuring agencies have a lot to do. And

I think if you were to say and now make sure these small business programs, that is 23 percent, have the integrity that they need, I think they would say that is not—I just need to get my stuff done.

Chairman COFFMAN. I am afraid I am going to have to—I have three minutes to get over there.

Mr. MILLER, MS. Gustafson, I just want to thank you so much for testifying today. I think that your testimony has been very revealing and certainly I think gives a blueprint to the Congress of the United States to take action on what I think is a very critical issue. Thank you so much.

Ms. GUSTAFSON. Thank you.

Mr. MILLER. Thank you.

[Whereupon, at 10:44 a.m., the Subcommittee was adjourned.]

STATEMENT OF BRIAN D. MILLER
INSPECTOR GENERAL
U.S. GENERAL SERVICES ADMINISTRATION

BEFORE THE

SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT AND REGULATIONS
COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES

MISREPRESENTATION AND FRAUD: BAD ACTORS IN
THE SMALL BUSINESS PROCUREMENT PROGRAMS

OCTOBER 27, 2011

Chairman Coffman, Ranking Member Schrader, and distinguished members, I want to thank you for the opportunity to testify about companies fraudulently obtaining preferential contract awards under small business contracting programs.

At the outset, I acknowledge that my office does not purport to know all the intricacies that extend to contracts between the federal government and small businesses. We do play a role, however, in investigating companies that have made false statements to obtain preferential small business contract awards under programs administered by the General Services Administration (GSA). I will focus my testimony on some examples of cases in that area and impediments to prosecution.

I would like to highlight what I see as the two major types of schemes to fraudulently obtain preferential small business contract awards: (1) falsely claiming to meet small business eligibility criteria and (2) fraudulently using an eligible small business as a "pass-through" so that an ineligible company will actually perform the work and receive most of the taxpayer dollars. We have seen both of these schemes in our investigations. We also have experienced, first-hand, some of the problems in prosecuting these cases, with the primary one being determining the loss to the United States.

My office is presently investigating a case jointly with Offices of Inspector General (OIGs) for the Small Business Administration (SBA) and the Department of Veterans Affairs (VA) involving alleged false statements to meet service-disabled veteran-owned small business eligibility requirements. The indictment alleges that the defendants, who obtained more than $6 million in federal contracts, falsely self-certified that the company was eligible for contracts designated for service-disabled veteran-owned small businesses. After October 1, 2010, when the VA began verifying self-certifications regarding service-disabled veteran status, the defendants allegedly created and submitted false documentation to the VA that supported their status claim. The documents showed the claimed disabled veteran had completed three tours in Vietnam and had received numerous medals and citations. According to federal records, however, this individual was never classified as a service-disabled veteran by the VA or the Department of Defense (DOD). Rather, he was honorably discharged in 1968 as a Senior Engineer Equipment Mechanic with the rank of Specialist E-5, after serving five years in the National Guard, during which he never even left the state on active duty.

My office is also investigating cases that involve improper pass-throughs. A joint investigation with Internal Revenue Service Criminal Investigation; the Army Criminal Investigation Command; and the Department of Interior, SBA and DOD OIGs resulted in multiple convictions for bid rigging, bribery, and other fraud. One part of that investigation showed that federal employees steered business to companies legitimately designated as 8(a), small disadvantaged, or HUBZone, and those businesses would then subcontract the bulk of the work to companies owned by the same federal employees. In exchange, the legitimate small businesses received a small percentage of the contract work. Among others, the defendants negotiated an

agreement with a tribally-owned business that had preferential 8(a) status. As part of the conspiracy, millions of dollars in government contracts were funneled to the tribal business, which kept small percentages of the contract value as "pass-through fees," then subcontracted the majority of the contract's value to the defendants' company.

These cases illustrate how wide-ranging the fraud can be, and how significantly it can derail the goals of federal small business contracting programs. Unfortunately, however, it is not always possible to find a civil or criminal remedy. Prosecutors normally look first for loss to the United States. Often, however, they cannot establish a monetary loss to the United States, as the government has received the value of the products and services for which it paid. Some of the matters we have investigated have been declined for prosecution on this basis. Of course, the real loss and damage is to the integrity of the small business programs and the lost opportunities underlying those programs, starting with the fact that a legitimate small business did not receive the contract.

I have first-hand experience with the problem of measuring the loss to the United States. As an Assistant United States Attorney for the Eastern District of Virginia, I worked a case in which a small business qualified for the Small Business Innovative Research (SBIR) program and entered into contracts for research with five different federal agencies. These federal agencies did not know that the small business had contracts with other federal agencies, because the small business certified that it had no other federal contracts to perform this work. In other words, it sold the same research to the federal government five times and was paid for it five times. As it turns out, the small business did not even do the research itself, but rather it had a professor and graduate students at a major university research laboratory do the research. Interestingly, the final product was probably a better product than what the small business could have produced. If the United States received a better product than what it contracted for, then what was the loss to the United States? Fortunately, for that case, I had a good answer: We paid for it five times. Because five different agencies paid for the one research product, I could show that the United States paid five times more than it was worth. Had the United States paid only once for the research, this would have been a more difficult case, even though the small business clearly committed fraud and defeated the objectives of the SBIR program.

We believe that a strong penalty is required to provide the necessary deterrence because fraudulent small business self-certifications are difficult to detect, and unscrupulous companies may expect to get away with false self-certifications. As the Encyclopedia of Crime and Justice notes, "the greater the temptation to commit a particular crime and the smaller the chance of detection, the more severe the penalty should be."[1] A strong penalty will help take the profit out of crime, which is an idea underlying our forfeiture and fraud laws.

[1] This notion is based upon a theory by Jeremy Bentham, who wrote in 1781: "To enable the value of the punishment to outweigh that of the profit of the offense, it must be increased, in point of magnitude, in proportion as it falls short in point of certainty."

In many cases, including orders under GSA Multiple Award Schedule contracts, federal agencies rely on self-certifications made by the vendors to determine eligibility to receive contracts designated for small businesses. In the case of fraudulent certifications of eligibility, economic loss should be defined as the full value of the contract to encourage prosecution and provide a more effective deterrent. The absence of a financial loss in small business eligibility fraud stifles effective prosecution, resulting in a significant societal cost that includes preventing legitimate contractors from obtaining program benefits. A proposal to amend the Sentencing Guidelines along these lines was included in a 2008 white paper by the National Procurement Fraud Task Force's Legislation Committee, which I co-chaired.

As the SBA Inspector General pointed out in her March 3, 2011, testimony before the U.S. Senate Small Business and Entrepreneurship Committee, a HUBZone conviction that resulted from an investigation conducted by her office led to a light $1,000 fine and two years of probation, because under the Sentencing Guidelines, credit had to be given for any benefit (goods and services) the United States received as a result of the defendant's wrongdoing. The reality in that case, however, was that a company in an economically disadvantaged area, which the United States is seeking to aid through the HUBZone program, was deprived of business because the defendant fraudulently claimed to qualify for the program. Amending the Sentencing Guidelines as proposed in the white paper would address this harm in future cases.

The white paper did not address the similar impediment to obtaining remedies for small business eligibility fraud in civil cases, both under the civil False Claims Act and the Program Fraud Civil Remedies Act. We believe that for these purposes as well, loss to the government should be defined as the full value of the fraudulently obtained contract when a company falsely represents that it is a small business.

The Small Business Jobs Act of 2010 did create a "rebuttable presumption" that the loss to the United States was the value of the contract. However, a contractor could overcome the presumption by showing the United States received what it paid for, which would put us right back where we started – with no monetary loss to the United States. As you are doubtless aware, the SBA has recently issued proposed regulations that would make the presumption irrefutable. In other words, as a matter of substantive law, the loss to the government would equal the value of the contract.

The Small Business Jobs Act also required the SBA to issue regulations that protect individuals and business concerns from liability in cases of unintentional errors, technical malfunctions, and similar situations. The proposed regulations implementing this provision would consider the company's internal management procedures governing size representation or certification, the clarity or ambiguity of the specific requirements, and the efforts made to correct an incorrect or invalid representation in a timely manner.

I certainly agree, given the complexities of many of the rules governing eligibility for preferential contracting programs, that companies should not be punished for innocent mistakes. However, our experience has shown that we need a significant penalty to act as a deterrent for those companies that willfully misrepresent their status in order to obtain government contracts intended for true small businesses. It would be beneficial to have this deterrent in both civil and criminal cases.

I would be pleased to answer any questions.

STATEMENT OF

PEGGY E. GUSTAFSON
INSPECTOR GENERAL
U.S. SMALL BUSINESS ADMINISTRATION

BEFORE THE

SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT, AND REGULATIONS
COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES

OCTOBER 27, 2011

INTRODUCTION

Chairman Coffman, Ranking Member Schrader, and distinguished members of the Subcommittee, thank you for giving the U.S. Small Business Administration (SBA) Office of Inspector General (OIG) an opportunity to discuss misrepresentation and fraud in preferential contracting opportunities for small businesses.

Since its founding in 1953, the SBA has delivered millions of loans, loan guarantees, contracts, counseling sessions, and other forms of assistance to small businesses. Other than disaster assistance, SBA assists small businesses primarily through three programmatic functions: Access to Capital (Business Financing); Entrepreneurial Development (Education, Information, Technical Assistance & Training); and Government Contracting (Federal Procurement).

The SBA OIG was established within SBA by statute to deter and detect waste, fraud, abuse and inefficiencies in these programs and in SBA operations. Every year, our staff of approximately 110 employees, which includes criminal investigators, auditors, attorneys, and program analysts, conducts criminal investigations, audits, and other reviews, resulting in numerous indictments, convictions and guilty pleas by fraud perpetrators and many recommendations to the agency for improvement of elimination of wasteful or inefficient practices. SBA OIG's investigations and audits, and recent audits from the government Accountability Office, have identified systematic challenges in SBA's management of its preferential contracting programs, and fraud and abuse by certain individuals who criminally seek unfair access to government contracting opportunities.

In keeping with the mandate of Section 15(g) of the Small Business Act, SBA's Office of Government Contracting sets goals with other Federal departments and agencies to reach the statutory goal of 23 percent in prime contract dollars to small businesses. This office also provides small businesses with subcontracting procurement opportunities, outreach programs, and training. SBA OIG's investigations and audits have identified systematic challenges in SBA's management of its preferential contracting programs, and fraud and abuse by certain individuals who criminally seek unfair access to government contracting opportunities.

PREFERENTIAL CONTRACTING PROGRAMS

The SBA OIG is very concerned about continued fraud and improper activity in the preferential contracting programs, particular the Section 8(a) Business Development, Historically Underutilized Business Zones (HUBZone), and Service-Disabled Veteran-Owned (SDVO) programs. While SBA helps eligible socially and economically disadvantaged 8(a) firms compete in the economy

through various business development activities, SBA has delegated its 8(a) contract execution functions to procuring agencies through partnership agreements. These partnership agreements establish the responsibilities between SBA and the procuring agencies for oversight, monitoring, and compliance with procurement laws and regulations governing 8(a) contracts.

Investigations

Most SBA OIG investigations of procurement fraud involve false statements by those who seek to exploit SBA programs for their personal gain by either: (1) falsely claiming to meet eligibility criteria; or (2) fraudulently using an eligible business as a "pass-through" so that an ineligible company will actually perform the work and receive most of the profits. If ineligible companies improperly profit from preferential contracting through fraud and illegal conduct, legitimate companies necessarily have fewer opportunities to benefit from these programs. Some significant examples of recent case activity for consideration are below:

- On October 13, 2011, Theodoros Hallas pled guilty to one count of conspiracy to commit wire fraud in connection with his role in a conspiracy with Rajesh Kumar Malik to misrepresent their eligibility to obtain set-aside contracts. The investigations of Malik and Hallas led investigators to uncover the alleged bribery, kickback, and money laundering scheme that resulted in the October 4, 2011 arrests detailed below.

- Four Virginia men, including two longtime employees of the U.S. Army Corps of Engineers, were arrested on October 4, 2011, on charges stemming from an indictment that accuses them of taking part in a conspiracy involving more than $20 million in bribes and kickback payments and the planned steering of a $780 million government contract to a favored contractor.

  The indictment details schemes to defraud the government using two major Federal contracts:

  The TIGER Contract. The Technology for Infrastructure, Geospatial, and Environmental Requirements (TIGER) contract is a sole source 8(a), Indefinite Delivery/Indefinite Quantity contract. Authorized agencies are able to procure goods or services from this contract without competition by submitting task orders. The current TIGER contract is a five-year contract running from Oct. 1, 2009 through Sept. 30, 2014. Over the term, the total award of orders placed against the TIGER contract is authorized to exceed $1 billion. EyakTek, an Alaska Native-owned small business based in Dulles, Va., was the prime contractor for the TIGER contract and subcontracted many of the orders from the U.S. Army Corps of Engineers to other businesses.

The CORES Contract. The Contingency Operations Readiness Engineering & Support (CORES) contract is a planned contract that is envisioned as an alternative or potential replacement to the TIGER contract. As planned, the CORES contract would be a five-year contract with an award potential for all contracts placed under it of up to $780 million. While this contract was planned to be competitive, the indictment alleges that the defendants worked with the chief technology officer and others at "Company A" to devise a scheme to steer the award of the CORES contract to "Company A." The intent was to use this contract as a way for "Company A" to funnel money and other things of value directly and indirectly to the defendants and others.

- On June 21, 2011, two men were indicted in U.S. District Court for the Middle District of Florida on one count of conspiracy and five counts of wire fraud. The indictment alleges that the subjects devised a scheme whereby they created a company for the purpose of obtaining a $100 million small business set-aside contract with the Department of Defense (DoD). The subjects used a nominee owner to create the appearance that their company was not affiliated with another firm that they controlled. Their firm had been the incumbent contractor on a previous DoD contract. The subjects allegedly submitted false and misleading information concerning the relationship between the two companies after the affiliation was challenged in the course of a size protest submitted to the SBA Office of Government Contracting. This is a joint investigation with the DCIS.

- On August 18, 2011, the owner of an 8(a) certified business pled guilty in the Eastern District of Virginia to one count of procurement of citizenship or naturalization unlawfully and one count of false statements. His 8(a) certified firm has received over $3 million in contracts set aside for 8(a) certified businesses. The investigation disclosed he obtained falsified U.S. citizenship documents from a Department of Homeland Security (DHS) employee and used the documents to obtain a Department of Defense security clearance. He also used the same falsified documents as a basis for his claim that he was a U.S. citizen on his firm's 8(a) application. This is a joint investigation with the DHS-OIG; DHS - Immigration and Customs Enforcement; Department of State - Diplomatic Security Service; and the Department of Labor - OIG.

Despite our success in bringing to justice many who have committed fraud in SBA preferential contracting programs, one significant impediment to prosecution stems from the fact that, in these cases, there has been no financial loss to the government. Unlike a case where a contractor has falsified invoices for goods or services that were not provided, in many cases of preferential contracting fraud the government does obtain the particular good or service that it paid for and sought to procure.

Without an associated and definable loss to the government, criminal prosecutors are sometimes reluctant to pursue action against these companies or, if they do pursue them, may only be able to obtain limited sentences. For example, in one recent HUBZone case in Kentucky that we were successful in getting a prosecutor to accept, we obtained a guilty verdict, but the sentence was only a $1,000 fine and two years probation. This light sentence was based upon Federal sentencing guidelines which require that, in determining the extent of loss, a credit must be applied for any benefit (i.e., goods and services) that the government obtains as a result of the defendant's wrongdoing.

In order to address this impediment and to enhance criminal prosecution and civil fraud recovery against those that commit fraud in obtaining or performing set-aside contracts, the SBA OIG has developed a legislative proposal to revise section 16(d) of the Small Business Act. Most significantly, this proposal would provide that in criminal or civil fraud prosecutions arising under SBA preferential contracting programs, the amount of loss to the government would equal the amount paid on the contract. In addition, the OIG proposal would:

(1) Impose penalties for false statements not already covered by the section, including fraudulent statements made to obtain a contract set aside for SDVO companies or to obtain grants or cooperative agreements under the SBIR and STTR programs;

(2) Enhance prosecution of "pass-through" contracts by adding a section that would provide that companies that submit invoices or requests for payment on preferential contracts would be deemed to certify that they are performing the required percentage of work on the contracts, and that false certifications would result in criminal penalties;

(3) Add provisions to cover false statements made to get into an SBA program, such as the 8(a) program, or false statements made to SBA in connection with the protest of a proposed contract award; and

(4) Revise the definition in the Small Business Act of a service disabled veteran to require that a person has been determined by the Department of Veterans Affairs or the Department of Defense as being service disabled (the current definition merely covers someone with a service-connected disability, without requiring that either agency has verified this condition.)

The SBA OIG urges the Committee to take up these proposals.

Other Tools: Suspension and Debarment

As a complement to criminal prosecution and civil fraud recovery, the SBA OIG promotes the use of the Federal suspension and debarment process where

contractors are prohibited from all procurement and other non-entitlement governmental programs for fraudulent and improper conduct. SBA OIG has submitted 84 suspension and debarment referrals to SBA since FY 2009. Of these referrals, 44 were related to contracting and 40 referrals were non-procurement issues. We believe the tools of suspension and debarment are effective enforcement mechanisms that must be proactively pursued against those who wrongfully obtain preferential contracting benefits.

In 2010, the SBA OIG presented the Agency with a plan to bring about a more robust suspension and debarment program. Although SBA has implemented portions of this plan, including the provision of additional training to Agency staff, it has not implemented critical elements of this proposal. In particular, SBA has not yet issued a notice to its employees emphasizing the importance of identifying and pursuing suspension and debarment, and has not implemented an effective program to ensure that key agency personnel, such as those who work on procurement protests and program eligibility reviews, are regularly referring potentially suspicious activity to the SBA suspension and debarment official. The SBA OIG believes that the Agency needs to change its culture so that employees understand that their mission includes not only assisting small businesses, but also ensuring accountability and integrity to prevent fraudulent and improper actions from depriving procurement opportunities for legitimate firms.

Audits

Past SBA OIG audits also have identified problems with SBA's oversight and administration of its preferential contracting programs. In many cases, we have found that SBA is not devoting sufficient resources to perform effective oversight of these programs. (See SBA OIG Audit Reports Nos. 5-18 and 6-15).

A recent audit of SBA's surveillance review process show these problems continue. (See SBA OIG Audit Report No. 11-11). SBA undertakes on-site visits, known as surveillance reviews, to review procuring agency files to determine, among other things, whether contracting offices are properly awarding and monitoring preferential contracts consistent with applicable regulations. Our review found that SBA had only evaluated a limited number of procuring offices over the past seven years, and did not use a systematic, thorough, or consistent approach in identifying which offices were reviewed or which information was evaluated.

In addition, although SBA delegated its 8(a) execution authority to procuring agencies over 10 years ago, and said that it would monitor procuring agency compliance with 8(a) requirements through its surveillance reviews, our audit of surveillance reviews found that this had not been done. Lastly, there are regulatory limits on subcontracting which serve as an important control to preclude small business set-aside contracts from becoming "pass-throughs" to large businesses. However, our audit found that the SBA review teams generally

did not evaluate whether small businesses and 8(a) firms were performing the percentage of work that is required by these regulations.

Other recent audits we completed (Audit 11-14: *SBA's Funding of Information Technology Contracts Awarded to Isika Technologies, Inc.* and Audit 11-08: *SBA's Procurement of Information Technology Hardware and Software through Isika Technologies, Inc.*) found that SBA had awarded a large 8(a) contract to a small business that was actually passing on the bulk of the work on to several non-8(a) companies. This example of a "pass-through" arrangement, where a non-8(a) businesses profit under the guise of a non-8(a) set-aside contract, is detailed below:

> During fiscal years (FY) 2009 and 2010, SBA awarded two Indefinite Delivery/Indefinite Quantity (IDIQ) contracts, a Blanket Purchase Agreement (BPA), and six purchase orders for the procurement of information technology (IT) hardware and software. These procurement vehicles totaled nearly $7.6 million and each was set-aside for award to an 8(a) Business Development program participant. The chosen firm, Isika Technologies, Inc (also doing business as iTechnologies) acted as a shell for its non-8(a) subcontractor, which then ordered the products of several large businesses, including Dell, Hewlett Packard, and Ingram-Micro.
>
> Because hardware and software are tangible manufactured items, the procurement was subject to the Nonmanufacturer Rule. (13 CFR 121.406) iTechnologies did not qualify as a manufacturer because they do not produce hardware or software, nor did they add value to the end products required by SBA. iTechnologies also did not qualify as a non-manufacturer because the end products were not those of small businesses, nor did SBA obtain the requisite waiver authorizing the procurement of the end products of large businesses. The acquisition team should have recognized that neither a small business nor an 8(a) set-aside contract should be awarded because the procurement would result in a "pass through" to large businesses.

Another audit that we are currently working on involves SBA's Mentor Protégé and Joint Venture Programs. Under these programs, SBA approves large, non-disadvantaged companies to partner with disadvantaged firms in performing set-aside contracts. Past audits have found that SBA has not devoted sufficient resources to effectively prevent abuse in these arrangements, and we will determine in our current audit whether the Agency has improved its oversight. One positive development is that SBA's recent revision of its 8(a) regulations eliminated some of the ambiguities regarding mentor protégé and joint venture arrangements, and enhanced reporting requirements for these arrangements. However, we believe that more can be done to establish effective controls to prevent abuse in these programs.

Related Top Management Challenges

The SBA OIG has identified two Top Management Challenges relating to SBA's preferential contracting programs:

- **Challenge 1. Procurement flaws allow large firms to obtain small business awards and agencies to count contracts performed by large firms towards their small business goals.**

SBA OIG audits and other governmental studies have shown widespread misreporting by procuring agencies since many contract awards that were reported as going to small firms have actually been performed by larger companies. While some contractors may misrepresent or erroneously calculate their size, most of the incorrect reporting results from errors made by government contracting personnel, including misapplication of small business contracting rules. In addition, contracting officers do not always review the on-line certifications that contractors enter into a governmental database prior to awarding contracts. The SBA needs to ensure that contracting personnel are adequately trained on small business procurement and are reviewing this database prior to awarding contracts.

The SBA also needs to address a loophole within General Services Administration Multiple Awards Schedule (MAS) contracts that contain multiple industrial codes. Currently, a company awarded such a contract can identify itself as small on individual task orders awarded under that contract even though it does not meet the size criteria for the applicable task. Thus, agencies may obtain small business credit for using a firm classified as small, when the firm is not small for specific orders under the MAS contract.

- **Challenge 6. The Section 8(a) Business Development (BD) program needs to be modified so more firms receive business development assistance, standards for determining economic disadvantage are justifiable, and SBA ensures that firms follow 8(a) regulations when completing contracts.**

The SBA 8(a) Business Development (BD) program was created to assist eligible small disadvantaged business concerns to compete in the American economy through business development. Previously, the Agency did not place adequate emphasis on business development to enhance the ability of 8(a) firms to compete, and did not adequately ensure that only 8(a) firms with economically disadvantaged owners in need of business development remained in the program. Companies that were "business successes" were allowed to remain in the program and continue to receive 8(a) contracts, causing fewer companies to receive most of the 8(a) contract dollars and many to receive none. The Agency has made some progress in addressing issues, but significant improvements are still needed.

CONCLUSION

Acquisition planning is the most critical part of the acquisition process and establishes the direction for subsequent actions throughout the procurement. According to Federal Acquisition Regulation, the purpose of acquisition planning is to ensure that the government meets its needs in the most effective, economical, and timely manner. SBA OIG investigations and audits evidence support for this principle. In many instances, attempts to defraud the government through false claims or misrepresentations can be identified through due diligence in the acquisition process and post award surveillance by contracting officials.

As noted by the SBA, contracts with the Federal, state and local governments represent an unparalleled opportunity for small businesses. In fact, the Federal Government is the world's largest purchaser of goods and services. For many small businesses, government contracts provide reliable, sustainable growth. SBA OIG will continue to focus its work to ensure Federal contracts are awarded to small businesses that deserve preferential contracting opportunities. With our interagency partners, SBA OIG will continue to pursue those who defraud the government by lying in order to gain access to Federal set-aside contracts.

10/27/2011 Inspector General Gustafson Question for the Record

1. Please explain the extent to which SBA uses third party data to verify eligibility for the contracting programs, and whether you believe increased use of third party data, including automated processes, could reduce the problems of fraud and misrepresentation in the small business programs.

2. Many of your recent reports focus on SBA's failures to follow the small business procurement rules. If SBA can't follow its own rules, what does it say about the health of the small business programs?

3. Are you concerned that SBA doesn't have a standard operating procedure for suspension and debarment? What impact does the lack of a SOP have when trying to enforce compliance with the programs?

4. Your 11-11 audit report indicates that, that over the past 7 years, SBA only evaluated 154 agencies' small business programs out of the more than 3,285 contracting activities – about 4% of the activities. Is this a sufficient control on contracting operations governmentwide?

5. Our Committee has done recent work to bring to light the impact of fraud and misrepresentation as it pertains to federal contracting. In the programs where certification is required, do the IGs believe enough is being done to catch fraud in applications?

6. Do you believe that SBA's proposed rule to make the value of the contract as the loss to the government irrefutable is a positive step to promote prosecution of bad actors?

7. What can we do to increase the use of suspension and debarment?

8. Your office has conducted numerous investigations on this subject, so why do you think some small businesses risk suspension, debarment, and prosecution to commit fraudulent activity under government contracts?

9. Who owns the blame for all for this fraudulent activity taking place under SBA small business procurement programs?

10. Does SBA provide small businesses with adequate information to allow them to properly certify to their size?

11. Does SBA sufficiently educate small business so that they understand what contracting with the government entails?

12. Do Contracting Officers adequately communicate with small businesses, explaining their obligations under a government contract? Do Contracting Officers themselves understand the special restriction that apply to small business contracting?

13. Why do small businesses agree to act as a front for large businesses? Is it a lack of comprehension, or is it simply a disregard for the rules?

14. Can you explain the delegation of 8(a) contracting authority from SBA to the agencies, and the problems it raises?

15. Please tell me what authority authorizes SBA to delegate the contracting execution and administration of the 8(a) program to other agencies, and what are the consequences of these delegations?

16. Earlier this year, your office audited the surveillance review process at SBA, which is the process by which SBA determines if contracting activities are following the requirements of the small business programs. Can you tell me more about what you learned, and what you think needs to change?

17. If the small business is not compliant with the rules of the small business program, what measures are available to enforce compliance?

18. What happens if a Contracting Officer knowingly fails to enforce the limitation on subcontracting or nonmanufacturer rule?

19. Do agencies have a standardized manner for tracking compliance with the small business programs?

20. If these programs are in place to help small businesses, how is SBA working with agency contracting officer and contractors to ensure compliance?

21. Your report of March 31 stated that the auditors found that there was no way to track limitation on subcontracting with 8(a) firms. I assume this is true for other small businesses programs as well. Would changing the restrictions from cost-based limitations to price based limitations make it easier to track compliance?

22. What guidance does SBA provide contracting officers on monitoring subcontracting limits? Is this type of guidance included in any contracting officers' training courses?

23. What is SBA's track record of complying with your recommendations on how to improve the government contracting programs?

24. Recent SBA OIG work evidences continued problems in application and enforcement of the nonmanufacturer rule, whereby the awardee must certify that it is manufacturing the product itself, or it must meet one of three exemptions. What can be done to protect the government's interest and ensure contractors are playing by the rules as it pertains to this certification?

25. When mistakes or fraudulent activity are uncovered, we always hear that the acquisition workforce needs more training and guidance to do a better job at applying these programs. Is this training available and how effective has it been to contractors and the acquisition workforce?

26. Much of your testimony seemed to boil down to deterrence and incentives. In your opinion, what do we need to change to deter fraud and incentivize prosecutions?

27. There are lots of government contracts data systems out there – do these assist your offices in catching bad actors? Could they do a better job?

10/27/2011 Inspector General Miller Question for the Record

1. When it comes to certification, the issues are usually best addressed by SBA. However, I understand that with the new Woman-Owned Small Business contracting program, contracting officers will be reviewing organizational and tax documents to determine ownership and control. Do you believe contracting officers at GSA are equipped to take on this responsibility?

2. How much of the fraud you detect is attributable to ignorance, and how much is intentional?

3. How does the Department of Justice's decision not to prosecute cases affect how you allocate your resources?

4. Do you believe the Program Fraud Civil Remedies Act provides an effective fraud remedy?

5. Do you see any control weaknesses with agencies relying on self-certifications to determine business size?

6. Do you see any control weaknesses with relying on contracting officers to review documentation supporting a certification of woman owned small business?

7. Should a company that is found to have misrepresented its size status be allowed to do business with the United States?

8. What is the simplest way to deter companies from misrepresenting their size status?

9. Do you agree with the legislative proposal advanced by the SBA IG to revised section 16(d) of the Small Business Act?

10. Our Committee has done recent work to bring to light the impact of fraud and misrepresentation as it pertains to federal contracting. In the programs where certification is required, do the IGs believe enough is being done to catch fraud in applications?

11. Do you believe that SBA's proposed rule to make the value of the contract as the loss to the government irrefutable is a positive step to promote prosecution of bad actors?

12. What can we do to increase the use of suspension and debarment?

13. Recent SBA OIG work evidences continued problems in application and enforcement of the nonmanufacturer rule, whereby the awardee must certify that it is manufacturing the product itself, or it must meet one of three exemptions. What can be done to protect the government's interest and ensure contractors are playing by the rules as it pertains to this certification?

14. When mistakes or fraudulent activity are uncovered, we always hear that the acquisition workforce needs more training and guidance to do a better job at applying these programs. Is this training available and how effective has it been to contractors and the acquisition workforce?

15. Much of your testimony seemed to boil down to deterrence and incentives. In your opinion, what do we need to change to deter fraud and incentivize prosecutions?

16. There are lots of government contracts data systems out there – do these assist your offices in catching bad actors? Could they do a better job?

17. If you were a small business trying to comply with the procurement programs, what steps would you take to make sure you were in compliance?

18. Are current penalties for fraud and miscertification too lax or not severe enough to actually deter or affect a change in behavior?

19. Of all the recommendations your office has made to eliminate fraud and improve the use of the small business procurement programs, what are your top three recommendations?

20. When you investigate cases of fraud involving the small business programs, why do you think the contracting officers have failed to catch these problems?

21. We've talked about penalties for bad actors in the small business community today, but what are the penalties for contracting officers who disregard, intentionally or unintentionally, the requirements of the small business programs?

10/27/2011 Inspector General Gustafson Question for the Record

1. Please explain the extent to which SBA uses third party data to verify eligibility for the contracting programs, and whether you believe increased use of third party data, including automated processes, could reduce the problems of fraud and misrepresentation in the small business programs.

SBA advised it currently uses a third party's database to verify initial and continuing eligibility of firms in certain preferential contracting programs. SBA further advised it is in the process of implementing a new system to manage their programs that will include a module for third party data validation. If implemented properly, the new system could help reduce fraud and mismanagement.

2. Many of your recent reports focus on SBA's failures to follow the small business procurement rules. If SBA can't follow its own rules, what does it say about the health of the small business programs?

As the advocate for small businesses, the SBA should be the role model for following small business procurement rules. Many of the findings in our recent reports were as a result of the SBA's lack of internal controls over their procurement process and contracting officers having limited training on small business programs. It would be prudent for the SBA to promote additional training to contracting officers to improve their knowledge that apply to small business contracting.

3. Are you concerned that SBA doesn't have a standard operating procedure for suspension and debarment? What impact does the lack of a SOP have when trying to enforce compliance with the programs?

The government-wide, non-procurement debarment and suspension regulations, and to a lesser extent the FAR provisions for procurement debarments, contain effective procedures. However, SBA's issuance of a debarment and suspension SOP would help: (1) require and/or encourage all SBA employees who work in positions that are likely to encounter potential integrity issues to make suspension and debarment referrals to the appropriate SBA officials; and (2) ensure consistency and a longer-term approach in undertaking suspension and debarment actions and preclude a more ad hoc approach to these administrative enforcement actions.

4. Your 11-11 audit report indicates that, that over the past 7 years, SBA only evaluated 154 agencies' small business programs out of the more than 3,285 contracting activities – about 4% of the activities. Is this a sufficient control on contracting operations governmentwide?

We do not believe reviewing 154 agencies small business programs is a sufficient control on contracting operations governmentwide. We reported that SBA did not use a nationwide systematic and analytical process for selecting and reviewing the contracting activities to ensure reasonable coverage of the 3,000 activities. We recommended that

SBA develop a strategy to ensure contracting activities that met SBA's selection criteria are identified, prioritized on a nationwide basis and targeted for surveillance reviews. As of January 2012, SBA has not taken action to address this recommendation.

5. Our Committee has done recent work to bring to light the impact of fraud and misrepresentation as it pertains to federal contracting. In the programs where certification is required, do the IGs believe enough is being done to catch fraud in applications?

SBA OIG has not surveyed other OIGs on this issue. However, from our perspective, it is very difficult to prevent fraud when companies are allowed to self-certify that they meet criteria to be considered a small business, a service-disabled veteran owned small business, or a women-owned small business. It is our experience that contracting offices are often overworked and understaffed and do not always conduct due diligence when there are questions as to whether a business meets eligibility criteria. Additionally, it is our view that the protest process does not provide enough time or information to competitors to be able to investigate or protest potentially incorrect or false certifications.

6. Do you believe that SBA's proposed rule to make the value of the contract as the loss to the government irrefutable is a positive step to promote prosecution of bad actors?

The language in the Small Business Jobs Act establishing a presumption on loss to equal the value of the contract, and SBA's regulations implementing this statutory provision, may be helpful in addressing occasional prosecutorial reluctance to take on what are perceived as "no-loss" cases. However, we believe that a more effective solution would be to enact explicit and expansive statutory authority clearly establishing that loss equals the value of the contract in both criminal and civil fraud cases and that this formula applies to all SBA contracting programs and the SBIR/STTR programs. Such statutory authority also should include a provision to direct the U.S. Sentencing Commission to apply these loss provisions to the Federal Sentencing Guidelines.

7. What can we do to increase the use of suspension and debarment?

Congress could promote suspension and debarment by directing greater resources to specifically fund these enforcement actions, holding additional hearings, and continuing to insist upon agency accountability for failing to take suspension or debarment actions when appropriate. Agencies are required to report on debarment actions taken through the Inter-agency Suspension and Debarment Committee's annual reports. Congressional scrutiny of those agencies that lack robust debarment and suspension programs would undoubtedly spur additional enforcement.

8. Your office has conducted numerous investigations on this subject, so why do you think some small businesses risk suspension, debarment, and prosecution to commit fraudulent activity under government contracts?

Opportunity is always a key ingredient to those who commit fraud against the government. When companies are allowed to self-certify that they have met the SBA standards for a small business, service-disabled, veteran-owned small business, or women-owned small business, fraud will occur. Financial pressures on businesses to obtain government contracts in a weak economy may be a factor. Businesses may also rationalize that their company is providing a valuable service to the government, even though they lied to receive the contract.

Limited staffing of contracting offices and SBA personnel to oversee and establish effective internal controls in the government contracting area may also contribute to fraud. Companies may recognize this limited staffing/oversight by the government and be more willing to commit fraud because they think there is little risk of being caught.

Finally, the government's inconsistent application of suspension and debarment actions may be a factor when a company's decides to commit fraud. If suspension and debarment actions were applied more effectively across the government, companies may decide that acquiring contracts illegally is not worth being barred from doing with business with the government for up to three years.

9. Who owns the blame for all for this fraudulent activity taking place under SBA small business procurement programs?

By definition fraud is a knowing misrepresentation of the truth or concealment of a material fact to induce another to act to his or her detriment. Those that commit fraudulent acts under the SBA small business procurement program are responsible for their actions.

10. Does SBA provide small businesses with adequate information to allow them to properly certify to their size?

Although SBA has taken actions to provide information to small business contractors, we believe the agency's regulations could be much clearer. For example, the SBA website provides user friendly information for businesses interested in participating in SBA's procurement programs, and provides information through its funding of agency small business development centers and through other entrepreneurial development programs throughout the country such as the Service Corps of Retired Executives. However, although SBA size standards are relatively clear, we believe that SBA should clarify the affiliation regulations, percentage of work and non-manufacturer regulations.

11. Does SBA sufficiently educate small business so that they understand what contracting with the government entails?

The SBA OIG has not conducted an audit or evaluated the sufficiency of how well SBA trains or educates the small businesses to ensure businesses understand government contracting. However, we are aware that SBA's local district offices facilitate training sessions for small businesses. In addition to the local offices, SBA has small business development and procurement technical assistance centers to educate small businesses on government contracting. Furthermore, SBA has online small business training on its public website.

12. Do Contracting Officers adequately communicate with small businesses, explaining their obligations under a government contract? Do Contracting Officers themselves understand the special restriction that apply to small business contracting?

The SBA OIG has not conducted any work that would allow us to provide specific responses to these questions. However, as pointed out in the OIG's Management Challenge #1, we believe that SBA should work to promote training to procurement personnel on small business requirements and procedures to improve their knowledge of special restrictions that apply to small business contracting. Importantly, the FAR specifies that Contracting officers are responsible for ensuring performance of all necessary actions for effective contracting, ensuring compliance with the terms of the contract, and safeguarding the interests of the United States in its contractual relationships. Importantly, the contracting officer is responsible for determining if a prospective contractor has adequate financial resources to perform the contract and is able to comply with the required or proposed delivery or performance schedule; has a satisfactory performance record, and has a satisfactory record of integrity and business ethics. In this capacity, contracting officers should communicate with contractors to ensure they comply with the contractual terms and conditions.

13. Why do small businesses agree to act as a front for large businesses? Is it a lack of comprehension, or is it simply a disregard for the rules?

We find that small or disadvantaged businesses who act as fronts for large businesses often do so with knowledge that they are committing an illegal act. In certain cases, the small business makes a conscious decision to "buy into" the scheme of the large business in order to make a profit by doing little, if any, work, and the large business willfully acts to recruit and "prop up" the small or disadvantaged business. As noted above, some contractors may have the perception that, given limited governmental oversight, there is a limited risk of getting caught.

14. Can you explain the delegation of 8(a) contracting authority from SBA to the agencies, and the problems it raises?

In the late 1990s, SBA issued regulations and implemented processes to delegate the authority for contracting to procuring agencies. This delegation has, in our opinion, resulted in reduced governmental oversight over the performance of 8(a) contracts, and, greater potential for large and/or non-disadvantaged companies to perform a disproportionate amount of work on 8(a) contracts. Although SBA takes the position that it is the procuring agency's responsibility to oversee contract performance, we have discussed this with contracting officers who were unaware of this expectation because they believed it was SBA's duty.

15. Please tell me what authority authorizes SBA to delegate the contracting execution and administration of the 8(a) program to other agencies, and what are the consequences of these delegations?

The SBA OIG is not aware of any statutory authority that specifically authorizes SBA to delegate execution of 8(a) contracts to procuring agencies or that specifically prohibits such a delegation. Consequences of these delegations are discussed in our response to question 14.

16. Earlier this year, your office audited the surveillance review process at SBA, which is the process by which SBA determines if contracting activities are following the requirements of the small business programs. Can you tell me more about what you learned, and what you think needs to change?

In a March 2011 audit, we reported that surveillance reviews conducted in FY 2009 by SBA did not adequately assess the small business programs of contracting activities. The Agency did not use a systematic and analytical process for establishing review priorities to ensure reasonable coverage of the contracting activities. In some cases the rationale for selecting activities was unrelated to the factors outlined in the SOP and candidates that should have been considered were not recommended for review because of the limits placed on the number of contracting activities that each area office could recommend for review. Also, in selecting activities for review, SBA did not consider information in anomaly reports, which are produced to identify discrepancies in small business reporting to the Federal Procurement Data System (FPDS). Further, although a major purpose of the surveillance reviews is to monitor 8(a) delegated contract execution authority, little consideration was given to 8(a) activity in selecting procurement centers. Finally, SBA did not follow-up on prior recommendations to ensure that deficiencies identified by surveillance review teams were corrected in a timely manner. According to SBA, a lack of staff resources and competing priorities prevented the agency from doing so.

We recommended that SBA: amend its selection criteria for identifying and prioritizing contracting activities to be reviewed; determine the level of effort needed to establish an effective monitoring process for small business procurement activities and the amount of resources needed to implement such a process; revise existing guidance related to

performing surveillance reviews; and develop and implement a plan to ensure that surveillance review reports are issued to contracting activities within a specific timeframe. Although not encompassed in our report, we also believe that additional resources would also help SBA develop a more effective surveillance review program.

17. If the small business is not compliant with the rules of the small business program, what measures are available to enforce compliance?

Criminal prosecution where there is a specific intent to defraud; civil fraud prosecution where there is a reckless disregard for the truth of the matter; suspension and debarment where there is a lack of business integrity (such as fraud or regulatory violations); and termination for default or for convenience if the company fails to comply with applicable requirements. Protests that are filed by competitors on procurement awards to identify announced awardees that do not meet eligibility criteria is another method to enforce compliance with the rules of the small business program.

18. What happens if a Contracting Officer knowingly fails to enforce the limitation on subcontracting or non-manufacturer rule?

According to FAR 1.6, contracting officers are responsible for ensuring performance of all necessary actions for effective contracting, ensuring compliance with the terms of the contract, and safeguarding the interests of the United States in its contractual relationships. Although contracting officers should be allowed some latitude to exercise business judgment, if they fail to enforce the FAR, the procuring agency can undertake disciplinary action including, in egregious cases, termination.

19. Do agencies have a standardized manner for tracking compliance with the small business programs?

Although we have not conducted an audit on this issue, based on our audit work on the Surveillance Review (Report No. 11-11), we did not identify a standard manner agencies use for tracking compliance with small business programs.

20. If these programs are in place to help small businesses, how is SBA working with agency contracting officer and contractors to ensure compliance?

Although our audit work on the Surveillance Review (Report No. 11-11) did not address this issue, we understand that the SBA coordinates with the Offices of Small and Disadvantaged Business Utilization (OSDBUs) to promote and implement the Federal small business contracting programs. In addition, SBA's district offices provide training and seminars to the contractors on the various small business programs.

21. Your report of March 31 stated that the auditors found that there was no way to track limitation on subcontracting with 8(a) firms. I assume this is true for other small businesses programs as well. Would changing the restrictions from cost-based limitations to price based limitations make it easier to track compliance?

Cost-based limitations are easier to track than price-based limitations.

22. What guidance does SBA provide contracting officers on monitoring subcontracting limits? Is this type of guidance included in any contracting officers' training courses?

SBA regulations and the FAR contain subcontracting limits (13 CFR § 125.6; FAR §§ 52.219-14, 52.219-27), and, as noted above, contracting officers are required to ensure that procurement actions comply with the FAR. The partnership agreement that SBA executes with procuring agencies to delegate responsibility for overseeing performance of 8(a) contracts states that it is the procuring agency's responsibility to oversee contractor compliance with the subcontracting limitations. However, these agreements are signed by the OSDBUs and anecdotal evidence indicates that contracting officials are not always informed about these agreements. It is possible that SBA provides other guidance to contracting personnel either through OSDBUs or SBA procurement center representatives, but we have not performed an audit or conducted a review of this issue. Our review of SBA's website noted that, although it contains a section entitled "for contracting officials," the site contains limited guidance on subcontracting limitations and does not appear to provide procurement personnel any guidance on monitoring these limitations. We have not performed an audit or review to determine whether the Federal Acquisition Institute or Defense Acquisition University procurement courses on small business contracting address monitoring of subcontracting limitations in any depth. A review of course objectives for the two most relevant courses (CON 260A and 260B) did not indicate that this issue was a primary focus of either course.

23. What is SBA's track record of complying with your recommendations on how to improve the government contracting programs?

The SBA is slow to implement some recommendations made in our audit reports and the SBA OIG management challenge on government contracting. Currently, the SBA has 33 audit recommendations pertaining to government contracting and business development programs that remain unimplemented. Of the 33 recommendations, 4 have been open since 2009 and the remaining 27 since 2011. In addition, the OIG has 10 recommendations that have not reached management decisions, which is the first step toward implementing recommendations.

24. Recent SBA OIG work evidences continued problems in application and enforcement of the nonmanufacturer rule, whereby the awardee must certify that it is manufacturing the product itself, or it must meet one of three exemptions. What can be done to protect the government's interest and ensure contractors are playing by the rules as it pertains to this certification?

Governmentwide, contracting officers need additional training on the application of the non-manufacturer rule. This training should be required for a contracting officer to obtain a Level I certification. While there are any number of actions that can be taken by a particular agency, we believe with better training and increased awareness of the non-manufacturer rule, contracting officers governmentwide will be in a better position to evaluate contract proposals. This will enable them to determine whether: the procurement qualifies as a small business procurement; a non-manufacturer waiver can be obtained; and the prime contractor is capable of performing contract requirements.

25. When mistakes or fraudulent activity are uncovered, we always hear that the acquisition workforce needs more training and guidance to do a better job at applying these programs. Is this training available and how effective has it been to contractors and the acquisition workforce?

SBA has provided training on fraud indicators to its staff responsible for reviewing eligibility requirements of firms to enter or remain in a particular program [i.e. 8(a) program, HUBzone] to increase awareness of possible risk factors as well as their responsibilities for reporting, and referring the matter to the appropriate investigative organization .

SBA OIG management challenge #1 recommends that SBA work with the appropriate Federal agencies to expand the amount of training that is provided on small business requirements and procedures to acquisition workforce. SBA is making progress in this area; however, additional action is necessary. Currently, as noted above, training on small business contracting is primarily offered through two courses by the DAU and FAI, Con 260A and Con 260B, which are elective courses. SBA has advised us that it is working with the DAU to modify these courses to expand coverage of Small Business programs. In addition, we also have been advised that the DAU is updating Level I through Level III contracting certification programs to include small business program training in courses necessary for these certifications. Concerning effectiveness of acquisition training, although we have not conducted an audit or review of this issue, GAO reported in October 2010 that DOD lacks complete information on the skill sets of the current acquisition workforce and does not have outcome-based metrics to assess results achieved in enhancing workforce proficiency and capability through training efforts.

26. Much of your testimony seemed to boil down to deterrence and incentives. In your opinion, what do we need to change to deter fraud and incentivize prosecutions?

To enhance criminal prosecution and civil fraud recovery against those that commit fraud in obtaining or performing set-aside contracts, the SBA OIG has developed a legislative proposal to revise section 16(d) of the Small Business Act. Most significantly, this proposal would make explicit that in criminal or civil fraud prosecutions arising under SBA preferential contracting programs, the amount of loss to the government would equal the amount paid on the contract. In addition, the OIG proposal would:

(1) Impose penalties for false statements not already covered by the section, including fraudulent statements made to obtain a contract set aside for SDVO companies or to obtain grants or cooperative agreements under the SBIR and STTR programs;
(2) Enhance prosecution of "pass-through" contracts by adding a section that would provide that companies that submit invoices or requests for payment on preferential contracts would be deemed to certify that they are performing the required percentage of work on the contracts, and that false certifications would result in criminal penalties;
(3) Add provisions to cover false statements made to get into an SBA program, such as the 8(a) program, or false statements made to SBA in connection with the protest of a proposed contract award; and
(4) Revise the definition in the Small Business Act of a service disabled veteran to require that a person has been determined by the Department of Veterans Affairs or the DoD as being service disabled (the current definition merely covers someone with a service-connected disability, without requiring that either agency has verified this condition.)

27. There are lots of government contracts data systems out there – do these assist your offices in catching bad actors? Could they do a better job?

Although there are other data systems, there are three governmentwide contracting data systems that are key to monitoring contractors:

(1) The Federal Procurement Data System – Next Generation (FPDS-NG), which provides information on government contracting actions, procurement trends, and achievement of socioeconomic goals, such as small business participation.
(2) The Past Performance Information Retrieval System (PPIRS), which consolidates federal contractor performance information collected by individual agencies.
(3) The Excluded Parties List System (EPLS), which maintains information on businesses or individuals that have been excluded from receiving contracts or other federal funds for a variety of reasons, including a serious failure to perform to the terms of the contract.

Reviews by GAO and Inspectors General across the government, including our office, have identified several weaknesses in contracting data systems. First, the data entered are not always accurate. Second, agencies do not always document required information or

input it into the systems. Finally, technical limitations also may reduce the effectiveness of contracting data systems. For example, GAO found cases where agencies awarded contracts to excluded parties even after checking EPLS because of inadequacies in the system's search function. When considering improvements to governmentwide contracting data systems, it is important to note that many, including FPDS-NG, PPIRS, and EPLS, depend on the efforts of multiple agencies.

January 25, 2012

10/27/2011 Inspector General Miller Question for the Record

1. When it comes to certification, the issues are usually best addressed by SBA. However, I understand that with the new Woman-Owned Small Business contracting program, contracting officers will be reviewing organizational and tax documents to determine ownership and control. Do you believe contracting officers at GSA are equipped to take on this responsibility?

At this time I do not believe GSA contracting officers are equipped to take on this responsibility. As I have previously stated, at this time the acquisition workforce is stretched thin, overworked, and undertrained. Accordingly, I do not think that relying on contracting officers to verify small business status would be effective.

2. How much of the fraud you detect is attributable to ignorance, and how much is intentional?

We recognize the need to protect individuals and small businesses from liability in cases of unintentional errors, technical malfunctions, and similar situations. If we determine that an overbilling or false certification is based on ignorance or a similar cause, we will not pursue it as a fraud case. Fraud requires that the statement be made intentionally or at least with reckless disregard for its truthfulness.

3. How does the Department of Justice's decision not to prosecute cases affect how you allocate your resources?

Because of limited resources, we have to choose what allegations to pursue. We do not believe it would be an effective use of resources for us to pursue cases we know will not be prosecuted criminally or as a civil False Claims Act case. We may, as appropriate, discuss allegations with an Office of United States Attorney to determine at the outset of an investigation if they will pursue the case if the evidence shows a knowing violation. We understand that U.S. Attorneys normally first look for loss to the United States. If they cannot establish a monetary loss because the government has received the value of the products and services for which it paid, then they frequently will not pursue the case. Due to the absence of an effective remedy, I do not believe it would be appropriate for me to expend further resources on those cases, even if the evidence indicates there has been a violation.

4. Do you believe the Program Fraud Civil Remedies Act provides an effective fraud remedy?

We understand that GAO is finalizing a report on implementation of the Program Fraud Civil Remedies Act (PFCRA) that may provide useful information on this question. We see several weaknesses in PFCRA that reduce its effectiveness, as has been previously pointed out by the Legislation Committee of the National Procurement Fraud Task Force. Those weaknesses include that (1) the upper dollar limit on PFCRA claims and penalties is currently too low, (2) agencies generally are not allowed to keep money they recover, and the costs of pursuing a PFCRA claim may dissuade agencies from expending their resources on a PFCRA claim, and (3) efficiencies could be improved if Offices of Inspector General (OIG) were allowed to conduct

PFCRA litigation. We have a proposal for a trial program at GSA that would address these issues if you would like further details.

5. Do you see any control weaknesses with agencies relying on self-certifications to determine business size?

Yes. There are no controls or checks and balances with self-certifications. We generally review self-certifications only if we receive an allegation. Alternatively, a competitor may file a protest.

6. Do you see any control weaknesses with relying on contracting officers to review documentation supporting a certification of woman owned small business?

Please see our answer to question 1 above.

7. Should a company that is found to have misrepresented its size status be allowed to do business with the United States?

We believe the rules for suspension and debarment should apply to size misrepresentations as they do to other misrepresentations. The Federal Acquisition Regulation (FAR) currently lists numerous potential causes for suspension and for debarment. Consideration should be given to also listing size misrepresentation as a ground for suspension and debarment in the FAR. As a ground for suspension and debarment, size misrepresentation would theoretically be sufficient for suspension and debarment, but would not necessarily require such action. As stated in the FAR, the existence of a cause for suspension or debarment does not necessarily require that a company be suspended or debarred. Rather, both the seriousness of the acts or omissions and any remedial measures or mitigating factors should be considered.

8. What is the simplest way to deter companies from misrepresenting their size status?

As I have stated, fraudulent small business self-certifications are difficult to detect, and unscrupulous companies may expect to get away with false certifications. We believe that a strong penalty is needed to help take the profit out of crime, which is an idea that underlies our forfeiture and fraud laws. We suggest that the simplest method to protect the integrity of the small business programs and legitimate small businesses would be to define the loss to the government as being the value of the contract. There are several methods to accomplish this goal. One would be to amend the sentencing guidelines as recommended by the Legislation Committee of the National Fraud Procurement Task Force and, in the civil context, to amend the Small Business Act as suggested by the SBA OIG. We believe these actions would provide the simplest and most effective method of deterrence. An effective suspension and debarment program can also serve as a useful deterrent.

9. Do you agree with the legislative proposal advanced by the SBA IG to revised section 16(d) of the Small Business Act?

We believe that proposal would significantly strengthen fraud deterrence in the Small Business Act and we support the SBA IG proposal.

10. Our Committee has done recent work to bring to light the impact of fraud and misrepresentation as it pertains to federal contracting. In the programs where certification is required, do the IGs believe enough is being done to catch fraud in applications?

We cannot speak for IGs in general. However, in many cases, including in GSA Multiple Award Schedule contracts, federal agencies rely on self-certifications. In our view, the use of self-certifications represents a balancing of trust and resources. The difficulty comes from trying to balance these two interests. While the government does not currently have the resources to verify all certifications, unscrupulous companies may expect to get away with false self-certifications. We believe that to protect the government's interests agencies should have some programs in place to at least verify a sample of significant self-certifications.

11. Do you believe that SBA's proposed rule to make the value of the contract as the loss to the government irrefutable is a positive step to promote prosecution of bad actors?

As we stated in comments on the proposed rulemaking, we strongly support this proposed rule. We are concerned, however, that the rule may not apply to criminal prosecutions, as it would not necessarily cause a revision to the Sentencing Guidelines. While we support the rule, we also recognize it may take some time for the courts to rule on its validity. We believe legislation that specifically contains the loss language, without creating a presumption, is a more direct way to address this issue. Finally, we note that even if the value of the contract is defined as the loss to the government, there still may be a category of cases that are not effectively handled due to the weaknesses in PFCRA and the monetary thresholds the Department of Justice may use in deciding what cases to pursue. One way to address these concerns is to amend PFCRA and to increase the per claim penalties in the False Claims Act for fraud above a certain threshold.

12. What can we do to increase the use of suspension and debarment?

We believe that the increased emphasis on suspension and debarment should be continued, including as appropriate reviews by OIGs of the programs at their agencies. We also suggest consideration be given to listing size misrepresentation as an independent grounds for suspension and debarment in the Federal Acquisition Regulation.

13. Recent SBA OIG work evidences continued problems in application and enforcement of the nonmanufacturer rule, whereby the awardee must certify that it is manufacturing the product itself, or it must meet one of three exemptions. What can be done to protect the government's interest and ensure contractors are playing by the rules as it pertains to this certification?

We would defer to the SBA OIG on this question.

14. When mistakes or fraudulent activity are uncovered, we always hear that the acquisition workforce needs more training and guidance to do a better job at applying these programs. Is this training available and how effective has it been to contractors and the acquisition workforce?

We would defer to the SBA OIG on this question.

15. Much of your testimony seemed to boil down to deterrence and incentives. In your opinion, what do we need to change to deter fraud and incentivize prosecutions?

Please see my answer to question 8. In summary, I think the simplest solution in this area is to define the loss to the United States as being equal to the value of the contract. Consideration also could be given to amending PRCRA and increasing the penalty amount in False Claims Act cases for any fraud that exceeds a certain threshold.

16. There are lots of government contracts data systems out there – do these assist your offices in catching bad actors? Could they do a better job?

Yes, government data systems assist us in our efforts to detect fraud/bad actors and yes, they could do a better job. The biggest challenge in utilizing government data systems for fraud detection is that vendor entries are often not current, accurate and complete, and the inherent inter-relationships between these data systems and data sets often precludes detection of indicia of false, misleading and/or fraudulent data. As a result, detection of fraud utilizing vendor data often requires more than one independent government system and/or public data systems to cross-check and verify the information or to obtain correct data. We believe the usefulness of these systems could be enhanced significantly by combining them into a single system, ensuring information on both prime and subcontractors is entered, and having them automatically generate notices when the data indicates a potential noncompliance. Currently, we have to go through each system to identify discrepancies; we believe these systems can be programmed to generate automatic notifications, which would make fraud deterrence and detection more effective.

17. If you were a small business trying to comply with the procurement programs, what steps would you take to make sure you were in compliance?

We believe the SBA or the GSA Office of Small Business Utilization would be in a better position to answer this question. We note, however, that a legislative safe harbor, such as specifying when reliance on counsel may be used as a defense, may be useful in this context.

18. Are current penalties for fraud and miscertification too lax or not severe enough to actually deter or affect a change in behavior?

I believe that currently many cases are not pursued civilly or criminally because there is no loss to the government. This gives unscrupulous companies an incentive to submit false certifications, which damages the integrity of the small business programs. In the absence of a strong penalty, I believe the potential profit outweighs the deterrence effect of being caught. Please see my response to questions 8 and 15.

January 25, 2012

19. Of all the recommendations your office has made to eliminate fraud and improve the use of the small business procurement programs, what are your top three recommendations?

Our top three recommendations are (1) define the loss of the United States as being equal to the value of the contract, (2) reform the PFCRA to address the weaknesses pointed out by the National Procurement Fraud Task Force, and (3) amend the Federal Acquisition Regulation to list size misrepresentation as an independent basis for debarment.

20. When you investigate cases of fraud involving the small business programs, why do you think the contracting officers have failed to catch these problems?

As I stated in response to question 1, at this time the acquisition workforce is stretched thin, overworked, and undertrained. I do not believe contracting officers are in a position in many cases to catch these problems. For example, they frequently have no basis to doubt the validity of a self-certification.

21. We've talked about penalties for bad actors in the small business community today, but what are the penalties for contracting officers who disregard, intentionally or unintentionally, the requirements of the small business programs?

The penalties for improper actions by contracting officers include a loss of their warrant for improprieties in carrying out their responsibilities and possible disciplinary action for misconduct. These sanctions are available to GSA management.

SAM GRAVES, MISSOURI
CHAIRMAN

NYDIA M. VELAZQUEZ, NEW YORK
RANKING MEMBER

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6315

House Committee on Small Business Subcommittee on Investigations, Oversight and Regulations
"Misrepresentation and Fraud: Bad Actors in the Small Business Procurement Programs"
Thursday, October 27, 2011, 10:00am
2360 Rayburn House Office Building

Witness List

The Honorable Peggy E. Gustafson
Inspector General
US Small Business Administration
Washington, DC

The Honorable Brian Miller
Inspector General
US General Services Administration
Washington, DC