

GAO

Testimony

Before the Subcommittee on Oversight
and Investigations, Committee on
Veterans' Affairs, House of
Representatives

For Release on Delivery
Expected at 10:00 a.m. EDT
Thursday, July 28, 2011

**SERVICE-DISABLED
VETERAN-OWNED SMALL
BUSINESS PROGRAM**

**Preliminary Information on
Actions Taken by Agencies
to Address Fraud and Abuse
and Remaining
Vulnerabilities**

Statement of Gregory D. Kutz, Director
Forensic Audits and Investigative Service

U.S. Government Accountability Office

GAO90

YEARS

1921-2011

ACCOUNTABILITY ★ INTEGRITY ★ RELIABILITY



Highlights of [GAO-11-589T](#), a testimony before the Subcommittee on Oversight and Investigations, Committee on Veterans' Affairs, House of Representatives

Why GAO Did This Study

The Small Business Administration (SBA) most recently reported in fiscal year 2010 that \$10.8 billion of federal contracts were awarded to Service-Disabled Veteran-Owned Small Businesses (SDVOSB). SBA's report also showed that, of this amount, \$3.2 billion was for Department of Veterans Affairs (VA) contracts. In 2009 and 2010, GAO reported on weaknesses in fraud-prevention controls that allowed 10 ineligible firms to receive millions of dollars in SDVOSB contracts. GAO was asked to update (1) agency actions in response to prior investigations of 10 case-study firms, the status of prior GAO recommendations, and the status of ongoing Inspector General (IG) investigations, and (2) the status of any new federal contract obligations associated with the case-study firms. This testimony provides preliminary information on GAO's ongoing work.

To address these objectives, GAO reviewed prior findings from audits and investigations of the SDVOSB program, and contacted SBA, VA, and agency IG officials for an update on actions taken in response to GAO's prior recommendations and the 10 case-study firms. GAO identified contract obligations awarded to the 10 case-study firms. GAO did not validate representations made by agency officials or determine whether any of the 10 case-study firms receiving contracts subsequent to the November 2009 testimony were eligible or not. GAO discussed information in this statement with SBA and VA officials who generally agreed with the findings.

View [GAO-11-589T](#) or key components. For more information, contact Gregory D. Kutz at (202) 512-6722 or kutzg@gao.gov.

July 28, 2011

SERVICE-DISABLED VETERAN-OWNED SMALL BUSINESS PROGRAM

Preliminary Information on Actions Taken by Agencies to Address Fraud and Abuse and Remaining Vulnerabilities

What GAO Found

SBA and VA have taken a number of positive actions in response to prior GAO findings and recommendations concerning the SDVOSB program, but the program remains vulnerable to fraud and abuse. For example, SBA requested all 10 previously identified case-study firms to change their SDVOSB status in the Central Contractor Registration (CCR) to show they are not eligible for SDVOSB contracts, and VA rejected 7 of the 10 firms from participation in its VetBiz program. However, as of July 2011, two of the firms rejected by VA continued to self-certify themselves as an SDVOSB in CCR which allows the firms to compete for governmentwide SDVOSB contracts. The fact that some firms continue to list themselves as SDVOSB firms in CCR despite VA finding them ineligible exposes the gaps that still exist in SDVOSB program fraud-prevention controls across the government. Agencies have also taken some actions to suspend some of the case-study firms. For example, SBA suspended four companies and three individuals associated with 2 of the 10 case-studies, making them ineligible for further contracts with the federal government.

In an effort to minimize the potential for fraud in the SDVOSB program, GAO made recommendations to SBA and VA concerning overall SDVOSB program improvements. In response to prior recommendations, SBA, VA, and other agencies have met to coordinate improvements. VA is also developing procedures to refer firms that knowingly misrepresent their status as an SDVOSB for debarment or suspension. GAO also suggested that Congress consider providing VA with additional authority and resources to expand its SDVOSB verification process governmentwide. There is currently a Senate bill that addresses this matter. SBA and VA concurred with GAO's conclusion that legislative changes would be needed to expand the VA verification process. Such action would help prevent firms from obtaining contracts from the rest of the government after VA found the firm to be ineligible. GAO inquiries to IG officials revealed that 6 of the 10 firms are currently under investigation. Further details can be provided once the cases have been fully adjudicated.

GAO's prior investigation found that 10 case-study firms that fraudulently or abusively misrepresented material facts related to their eligibility for the SDVOSB program had received approximately \$100 million in SDVOSB sole-source and set-aside contracts, and an additional \$300 million in other federal contracts. Subsequent to GAO's reporting on this, from November 2009 to March 2011, the 10 firms received more than \$100 million in additional obligations on federal contracts, of which approximately \$16 million in obligations were associated with SDVOSB set-aside contracts. GAO did not investigate the additional contract obligations to determine whether or not they were appropriate; however, GAO plans to review the basis for these actions and the firms' continued participation in the SDVOSB program as part of its ongoing work and will include these results in its final report.

Chairman Johnson, Ranking Member Donnelly, and Members of the Subcommittee:

Thank you for the opportunity to discuss the results of our ongoing audit of the Service-Disabled Veteran-Owned Small Business (SDVOSB) Procurement Program. The SDVOSB program is intended to honor the service rendered by veterans with disabilities incurred or aggravated in the line of duty. The program permits contracting officers to award set-aside and sole-source contracts to small-business concerns owned and controlled by one or more service-disabled veterans. The Small Business Administration (SBA) stated in its most recent report that, in fiscal year 2010, \$10.8 billion in federal contracts¹ were awarded to firms that self-certified themselves in the Central Contractor Registration (CCR)² as SDVOSBs. Self-certification as an SDVOSB in CCR allows firms to bid on SDVOSB sole-source and set-aside contracts across the government. The Department of Veterans Affairs (VA) SDVOSB contracts accounted for \$3.2 billion or approximately 30 percent of governmentwide SDVOSB contracts during fiscal year 2010. In 2011 more than 15,500 firms were listed in CCR that self-certified themselves as SDVOSBs and approximately 5,500 firms were listed as verified by VA as SDVOSBs in VA's online database called the VetBiz Vendor Information Pages (VetBiz).

In 2009 and 2010, we reported on weaknesses in fraud prevention-controls that allowed ineligible firms to receive millions of dollars in SDVOSB contracts.³ At that time, we found that the governmentwide SDVOSB program was primarily a self-certification program. VA did have specific statutory authority to implement a SDVOSB verification program,⁴ but that authority was limited to contracts awarded by VA. During our previous work, we found that SBA was not obligated to institute any type

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

²CCR is the primary registrant database for the U.S. federal government. CCR collects, validates, stores, and disseminates data in support of agency acquisition missions, including federal agency contract and assistance awards.

³See app. I for a list of related GAO products discussing SDVOSB contracting.

⁴Veterans Benefits, Health Care, and Information Act of 2006, Pub. L. No. 109-461, 120 Stat. 3433 (2006), Veterans Small Business Verification Act of 2010, Pub. L. No. 111-275, 124 Stat. 2868 (2010).

of fraud prevention controls within the SDVOSB program. SBA was not verifying the eligibility of firms claiming to be SDVOSBs, and did not have a process in place to access the VA service-disabled veteran's database listing individuals that are valid service-disabled veterans. Unlike other small-business contracting programs, such as the HUBZone and 8(a) programs,⁵ there were no document submission requirements for the SDVOSB program used to substantiate eligibility, and no application process associated with the SDVOSB program. The only process in place to detect fraud in the SDVOSB program involved a formal bid-protest process, whereby interested parties to a contract award could protest a firm's status with SBA if they believed that a firm misrepresented its small-business size or SDVOSB eligibility.

In addition to SBA's statutory authority over administration of the SDVOSB program, the Veterans Benefits, Health Care, and Information Technology Act⁶ requires VA to institute controls for VA SDVOSB contracts.⁷ Specifically, as of October 2010 the act requires VA to maintain a database of SDVOSBs and Veteran-Owned Small Businesses (VOSB) and that VA verify the eligibility of these firms. The act requires that VA only use its set-aside and sole-source award authority to SDVOSB firms listed in the database. At the time of our December 2009 testimony, VA already had its database of SDVOSBs and VOSBs—VetBiz—online and reported plans for a validation program that would include steps such as document reviews and site visits to verify a firm's eligibility for firms wanting to obtain SDVOSB contracts from VA. Beyond

⁵SBA's 8(a) program was created to help small, disadvantaged businesses compete in the American economy. Firms must submit documents to the SBA documenting a variety of eligibility criteria including the owner's net worth and control of the business. The HUBZone program was established to provide federal contracting preferences to small businesses operating in economically distressed communities.

⁶Veterans Benefits, Health Care, and Information Act of 2006, Pub. L. No. 109-461, 120 Stat. 3433 (2006).

⁷The Veterans Small Business Verification Act, Pub. L. No. 111-275, § 104, 124 Stat. 2864, 2867 (2010), (Pub. L. No. 111-275, Oct. 13, 2010) requires that effective October 13, 2010, no new small-business applicant may appear in VA's SDVOSB and VOSB database unless it has been verified as owned and controlled by a veteran or service-disabled veteran. Additionally, VA was required to notify all unverified businesses in its veteran-owned small-business and service-disabled veteran-owned small-business database as of October 13, 2010, about the need to provide supporting business documents that establish the veteran ownership and control of the small-business. Firms were required to do so by 90 days of receipt of the notification in order to avoid removal of the firm from VA's database.

VA, contracting officers at other agencies were not required to validate whether a firm met eligibility requirements for participation in the SDVOSB program prior to award.

Our prior work found that the lack of an effective governmentwide fraud-prevention program left the SDVOSB program vulnerable to fraud and abuse. To demonstrate the potential effect of this vulnerability, we investigated and reported on 10 case-study firms⁸ that in total received approximately \$100 million in sole-source and set-aside SDVOSB contracts despite being ineligible for the program. The 10 case-study firms exploited the lack of an effective governmentwide fraud-prevention program using a variety of schemes, including several firms setting up front companies in order to pass SDVOSB contracts to large, sometimes multinational firms who were ineligible for the program. Other firms received contracts even though there was not a service-disabled veteran associated with the firm, or received contracts even though the service-disabled veteran associated with the firm did not manage or control the business. At the time of our work, 2 of the 10 firms had passed VA's verification process and were listed in its system as verified SDVOSB firms. In an effort to minimize the potential for fraud and abuse in the SDVOSB program, we recommended that SBA and VA explore the feasibility of improving governmentwide program controls by expanding the use of VA's VetBiz system to the rest of the federal government. In addition, we recommended that SBA refer cases where firms misrepresented their eligibility for the program to the SBA Inspector General (IG) for further review and investigation.⁹ SBA and VA generally agreed with our recommendations.

My testimony today provides an update on actions taken by federal agencies in response to our findings. Specifically, I will address (1) agency actions in response to our prior investigations of 10 case-study firms, the status of past recommendations, and the status of ongoing IG investigations, and (2) the status of any new federal contract obligations associated with the case-study firms.

⁸The case-study firms include all affiliated companies and individuals.

⁹GAO, *Service-Disabled Veteran-Owned Small Business Program: Case Studies Show Fraud and Abuse Allowed Ineligible Firms to Obtain Millions of Dollars in Contracts*, [GAO-10-108](#) (Washington, D.C.: October 23, 2009).

To address our objectives, we reviewed prior findings from GAO audits and investigations of the SDVOSB program. To provide an update on actions taken by various federal agencies, we requested information from SBA and VA on any actions that they have taken in response to our recommendations and any actions taken related to the 10 case-study firms.¹⁰ We did not validate representations made by SBA or VA. We also searched the CCR to determine whether case-study firms self-certified themselves as SDVOSB firms. In addition, we searched in VA's VetBiz online system to determine whether case-study firms were listed in the system as verified SDVOSB firms. Additionally, we searched the Excluded Parties List System (EPLS) to determine if any agencies had suspended or debarred¹¹ the case-study firms or related individuals previously investigated by GAO. To provide an update on contract obligations made to case-study firms, we extracted any contract obligations received by the case-study firms since November 2009 from the Federal Procurement Data System – Next Generation (FPDS-NG). We did not investigate these contract obligations to determine whether they were appropriate or whether the firms were eligible at that time to receive the contracts. To assess the reliability of the data sources, including EPLS, FPDS-NG, and VetBiz, we interviewed agency officials and traced information to source documents when possible. We determined that the data were sufficiently reliable for the purpose of our audit. Lastly, we contacted agency IGs who received GAO fraud referrals pertaining to the 10 case-study firms to learn of any action taken against the firms. We discussed the information in this statement with SBA and VA officials who generally agreed with our findings.

We conducted our work from February 2011 to July 2011 in accordance with U.S. generally accepted government auditing standards. Those

¹⁰For our prior work, we selected cases based on a variety of factors including facts and evidence provided in protests and allegations, whether a firm received multiple SDVOSB contracts, and whether a firm received other non-SDVOSB contracts. Our prior work was not designed to identify all firms that misrepresent themselves as SDVOSBs or commit fraudulent or abusive activity, and case examples could not be projected to the overall population of SDVOSB firms.

¹¹Suspension and debarment actions prevent companies and individuals from participating in government contracts, subcontracts, loans, grants and other assistance programs. The effect of suspension and debarment by a federal agency is governmentwide. Suspensions are temporary actions which may last up to 1 year and are effective immediately. Debarments results in the imposition of a set period of time decided on a case-by-case basis.

standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained, and the analysis conducted, provides a reasonable basis for our findings and conclusions in this product.

VA and SBA Officials Have Taken Action in Response to GAO Reports

SBA and VA officials have taken a number of actions in response to our investigation of the 10 case-study firms and in response to recommendations for program control improvements. At the time of our previous work, all 10 case-study firms had self-certified in CCR that they met SDVOSB eligibility criteria, and several of the firms were also listed in VA's VetBiz database as a verified SDVOSB firm. Since our prior work, SBA stated it has requested all 10 case-study firms to change their status in CCR to show they are not eligible for SDVOSB contracts. However, as of July 2011, several of the firms continued to self-certify themselves as SDVOSBs in CCR.

VA officials stated that since our report, all 10 case-study firms were reviewed through the VetBiz verification process and 7 of the 10 firms were rejected from VetBiz and are no longer listed in the online database. According to VA, the other three firms were reviewed through VA's verification process and found to be currently eligible for the program. However, VA verification files show some of the firms made changes to their operating practices and ownership structure in response to our prior findings. Of the 7 firms found to be ineligible, two firms continue to self-certify SDVOSB eligibility in CCR. The fact that the two firms continue to list themselves as SDVOSB firms in CCR despite VA finding them to be ineligible exposes the gaps that still exist in SDVOSB program fraud-prevention controls across the government. The gap in controls exists because contracting officers for non-VA agencies are only required to check contractor self-representations in CCR concerning a firm's SDVOSB status, and are not required to use the VetBiz system. We have received dozens of allegations of continuing fraud and abuse within the SDVOSB program since our last report. We are investigating several of these cases and will report the results at a later date.

In addition to removal of firms from online contracting databases, officials have taken actions to suspend some of the case-study firms. Specifically, SBA suspended four firms associated with 2 of the 10 case-studies we identified, which makes these firms ineligible from obtaining further contracts with the federal government. In one of the cases, SBA reported that a principal owner of a case-study firm created a second independent

SDVOSB company and defrauded the program again. SBA suspended the new second company as well as the original firm. In addition, SBA suspended three individuals associated with two of the case studies. SBA also mentioned that another firm is currently under review for suspension, and that SBA has chosen not to pursue suspension on other cases because of what they determined to be a lack of proof or because of ongoing IG investigations. SBA found one of the case-study firms ineligible for the SDVOSB program through its bid-protest process. VA officials stated that they have reviewed several case-study firms for possible suspension and are currently working to suspend one case-study firm.

In an effort to minimize the potential for fraud and abuse in the SDVOSB program, we made several recommendations to SBA and VA concerning overall SDVOSB program improvements. Specifically, we recommended that SBA and VA work with the Office of Federal Procurement Policy (OFPP) to explore the feasibility of expanding the use of VetBiz to the rest of the government, and recommended that all contractors who knowingly misrepresent their status as an SDVOSB be debarred for a reasonable period of time. In addition, we suggested Congress consider providing VA with additional authority and resources necessary to expand its SDVOSB eligibility verification process to all contractors seeking to bid on SDVOSB contracts governmentwide. There is currently a Senate bill that addresses this matter.¹² In response to recommendations made, SBA stated it has met with VA, OFPP, and other agency officials in an effort to coordinate on program improvements, such as the expansion of the use of VetBiz. However, according to SBA and VA officials, they concur with our prior reporting that legislative changes would be needed in order for federal agencies to change the governmentwide SDVOSB program from a self-certification process into using VA's VetBiz verification program for all contractors seeking to bid on SDVOSB contracts governmentwide. VA officials also stated that an increase of resources would be needed if VA's SDVOSB verification process expands governmentwide.

VA officials also stated that they are developing procedures to refer firms who misrepresent their status as an SDVOSB for debarment or suspension. However, SBA officials stated that proving a firm willfully

¹²Small Business Contracting Fraud Prevention Act of 2011, S.633, 112th Cong. § 4 (2011).

intended to misrepresent itself as an SDVOSB can be difficult. In September 2010, Congress enacted the Small Business Jobs Act of 2010, which, in part, amended the Small Business Act to facilitate prosecution of companies that willfully seek and receive small-business awards through misrepresentation of their small-business status, including SDVOSB.¹³ Under the act, willful and intentional misrepresentation can be demonstrated by showing that a company registered on any federal electronic database in order to be considered for award of a contract as a small business or submitted a bid or proposal for a small business set-aside. Punishments include a fine of not more than \$500,000 or imprisonment for not more than 10 years, or both.¹⁴ SBA officials also told us that they are actively reviewing each SDVOSB contract protest decision to determine if a referral to their respective IG offices is warranted. SBA stated that they have enhanced their bid-protest process by requiring firms found to be ineligible to decertify their status in CCR within 30 days or face being referred to the SBA IG. In addition, VA has developed its own SDVOSB bid-protest process to respond to protests on specific SDVOSB contract awards.

Upon completion of our investigation of 10 case-study firms in 2009, we referred all 10 firms to the appropriate IG officials at various federal agencies. In response to our referrals, several IGs have joined forces to pursue these firms. Recent inquiries revealed 6 of the 10 firms are currently under investigation, and face criminal or civil penalties, or both. Further details can be provided once the cases have been fully adjudicated.

¹³Pub. L. No. 111-240, § 1341, 124 Stat. 2543-44 (Sept. 27, 2010) (codified as amended at 15 U.S.C. § 632(w)).

¹⁴15 U.S.C. §§ 657f(d), 637(m), 645.

Case-Study Firms Have Received New Contract Obligations and Additional Obligations on Existing Contracts

Our prior investigation found that 10 case-study firms that fraudulently or abusively misrepresented material facts related to their eligibility for the SDVOSB program had received approximately \$100 million in SDVOSB sole-source and set-aside contracts, and an additional \$300 million in other federal contracts. Subsequent to our reporting on this fraud and abuse, from November 2009 to March 2011, the firms received more than \$100 million in additional obligations on federal contracts.¹⁵ All 10 firms received additional obligations since November 2009 ranging from less than \$100,000 to more than \$20 million in additional obligations. Of the more than \$100 million in obligations, approximately \$16 million in obligations was associated with SDVOSB set-aside contracts, of which approximately \$8 million was associated with obligations on contracts that had been awarded after November 2009. We did not investigate the additional contract obligations to determine whether or not they were appropriate; however, as part of our ongoing work we plan to more fully review the basis for these actions, including the receipt of additional obligations relative to the timing of suspensions, and the firms' continued participation in the SDVOSB program. We will include these results in our final report.

Chairman Johnson and Ranking Member Donnelly, this concludes my statement. I would be pleased to respond to any questions you may have.

Contacts and Acknowledgments

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

¹⁵Dollar amounts relate to federal contract obligations made to the 10 case studies from November 13, 2009 to March 4, 2011.

Appendix I: Related GAO Products

Service-Disabled Veteran-Owned Small Business Program: Fraud Prevention Controls Needed to Improve Program Integrity, [GAO-10-740T](#). Washington, D.C.: May 24, 2010.

Department of Veterans Affairs: Agency Has Exceeded Contracting Goals for Veteran-Owned Small Businesses, but It Faces Challenges with Its Verification Program, [GAO-10-458](#). Washington, D.C.: May 28, 2010.

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

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

Service-Disabled Veteran-Owned Small Business Program: Case Studies Show Fraud and Abuse Allowed Ineligible Firms to Obtain Millions of Dollars in Contracts, [GAO-10-108](#). Washington, D.C.: October 23, 2009.

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

GAO's Mission

The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday afternoon, GAO posts on its Web site newly released reports, testimony, and correspondence. To have GAO e-mail you a list of newly posted products, go to www.gao.gov and select "E-mail Updates."

Order by Phone

The price of each GAO publication reflects GAO's actual cost of production and distribution and depends on the number of pages in the publication and whether the publication is printed in color or black and white. Pricing and ordering information is posted on GAO's Web site, <http://www.gao.gov/ordering.htm>.

Place orders by calling (202) 512-6000, toll free (866) 801-7077, or TDD (202) 512-2537.

Orders may be paid for using American Express, Discover Card, MasterCard, Visa, check, or money order. Call for additional information.

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm

E-mail: fraudnet@gao.gov

Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

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

Public Affairs

Chuck Young, Managing Director, youngc1@gao.gov, (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, DC 20548

