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Testimony

Before the Committee on Small Business,
House of Representative

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

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

Statement of Gregory D. Kutz, Managing Director
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Madam Chairwoman and Members of the Committee:

The Small Business Administration (SBA), which, along with federal procuring activities, administers the Service-Disabled Veteran-Owned Small Business (SDVOSB) program, reported in fiscal year 2008 that \$6.5 billion¹ in federal contracts were awarded to firms who self-certified themselves as SDVOSBs. Government contracts to SDVOSBs accounted for only 1.5 percent of all government contract dollars paid in fiscal year 2008. Since the SDVOSB program began, the government has not met its annual mandated goal of 3 percent.² In addition to SBA's statutory authority over administration of the SDVOSB program, several other government agencies have separate authority over issues related to the SDVOSB program. The Veterans Benefits, Health Care, and Information Technology Act³ requires the Department of Veterans Affairs (VA) to maintain a database of SDVOSBs and Veteran-Owned Small Businesses (VOSB) so contractor eligibility can be verified on VA SDVOSB and VOSB contracts. In addition, The Office of Federal Procurement Policy (OFPP), within the Office of Management and Budget, provides overall direction for governmentwide procurement policies, regulations, and procedures and to promote economy, efficiency, and effectiveness in the acquisition processes. The Office's primary focus is on the Federal Acquisition Regulation (FAR), the governmentwide regulation governing agency acquisitions of goods and services, including SDVOSB set-aside and sole-source contract actions.

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

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

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

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

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

To identify examples of firms that received SDVOSB contracts through fraudulent or abusive eligibility misrepresentations, we reviewed SDVOSB contract awards and protests filed with SBA since the program's inception in 2003. We also reviewed allegations of fraud and abuse sent to our fraud hotline, FraudNET. In addition, we posted inquiries on our Web page and on several veteran advocacy-group Web pages and newsletters seeking information on fraud or abuse of the SDVOSB program. We received over 100 allegations of fraud and abuse in the SDVOSB program. From these sources, we selected 10 cases for further investigation based on a variety of factors, including facts and evidence provided in protests and allegations, whether a firm received multiple SDVOSB contracts, and whether a firm received other non-SDVOSB contracts. To investigate these case studies, we interviewed firm owners and managers and reviewed relevant documentation, such as business filings and tax returns, to determine if SDVOSB eligibility requirements had been met. We also analyzed data from Federal Procurement Data System–Next Generation (FPDS-NG) for years 2003 through 2009⁵ to identify SDVOSB contracts received by the firms since the program's inception. Furthermore, we reviewed certifications made by firms, such as certifications about a firm's size, SDVOSB status, and line of business, in the federal government's Online Representations and Certifications Application (ORCA).⁶ To determine whether the program has effective fraud-prevention controls in place, we reviewed relevant laws and regulations governing the SDVOSB program. We also interviewed agency officials about their responsibility over the program and controls currently in place to prevent or detect fraud and abuse. Additional details on our scope and methodology can be found in our report that we issued today.⁷

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

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

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

⁷[GAO-10-108](#).

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

Ineligible Firms Obtain Millions of Dollars in SDVOSB Contracts

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

Federal regulations set requirements for a small business to qualify as an SDVOSB. Specifically, SDVOSB eligibility regulations mandate that a firm must be a small business⁹ and at least 51¹⁰ percent-owned by one or more

⁸15 U.S.C. §631 et seq. 13 CFR Parts 125 and 134.

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

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

service-disabled veterans¹¹ who control the management¹² and daily business operations of the firm. In addition, SDVOSB regulations also place restrictions on the amount of work that can be subcontracted. Specifically, regulations require the SDVOSB to incur a mandatory percentage of the cost of the contract performance that can range from 15 percent to 50 percent, depending on the type of goods or services. The Federal Acquisition Regulation (FAR) requires all prospective contractors to update ORCA to state whether their firm qualifies as an SDVOSB under specific North American Industry Classification System (NAICS) codes. Pursuant to 15 U.S.C. § 657 f(d), firms that knowingly making false statements or misrepresentations in certifying SDVOSB status are subject to penalties. Of the 10 cases we identify, all 10 of them represented to be SDVOSBs in the Central Contractor Registration (CCR).¹³ Table 1 provides details on our 10 case-study firms that fraudulently or abusively misrepresented material facts related to their eligibility for the SDVOSB program. We have referred all 10 firms to appropriate agencies for further investigation and consideration for removal from the program.

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

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

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

Table 1: Case-Study Firm Details

Case	Industry business location	SDVOSB contracts ^a for years 2003-2009, ^b and awarding agency	Case details
1	Maintenance/repair North Las Vegas, Nev.	\$7.5 million—Federal Emergency Management Agency (FEMA)	<ul style="list-style-type: none"> • Firm is ineligible because majority owner is not a service-disabled veteran. • Firm’s ineligibility was determined by SBA during a bid protest in June of 2007. • After the SBA protest, in July of 2007 FEMA sent the firm a letter providing approximately 30-days to vacate SDVOSB contract awards. • Company continues to receive tens of millions in non-SDVOSB contracts. • SBA determined the firm was ineligible: however, the firm has not been suspended or debarred from receiving federal contracts.
2	Construction and janitorial services Chico, Calif.	\$5 million—VA, U.S. Fish and Wildlife Service, Agricultural Research Service, U.S. Forest Service	<ul style="list-style-type: none"> • Firm is ineligible because it does not perform any work and subcontracts 100 percent of the work to non-SDVOSB firms. • Our investigation found firm employs three full-time workers and performs SDVOSB contract work with employees from a large international-based corporation that reported almost \$12 billion in annual revenue in 2008. • Received over 20 SDVOSB contracts since 2008.
3	Construction/maintenance/repair Carnegie, Pa.	\$39.4 million—VA	<ul style="list-style-type: none"> • Firm is ineligible because a non-service-disabled veteran manages and controls the firm’s daily operations. • Firm’s ineligibility was determined by SBA during a bid protest. • Despite being determined ineligible, VA allowed the firm to continue multiple SDVOSB contracts, because there are no requirements for agencies to terminate contracts awarded to ineligible firms. • Non-SDVOSB construction company, located at the same address, manages and performs the SDVOSB contract work. • Service-disabled veteran owned and managed a restaurant in another city over 80 miles away when the contract was awarded. • SBA determined the firm was ineligible: however, the firm has not been suspended or debarred from receiving federal contracts.

Case	Industry business location	SDVOSB contracts ^a for years 2003-2009, ^b and awarding agency	Case details
4	Construction/ environmental/defense technology/maintenance San Diego, Calif.	\$12.2 million—Environmental Protection Agency (EPA), FEMA	<ul style="list-style-type: none"> • Firm is ineligible because it is not a small business. • Our investigation determined that federal agencies have obligated approximately \$171 million for payment to the firm during fiscal years 2003 to 2009 exceeding SBA size standards for average annual receipts. • Firm is also ineligible because it has formed at least five SDVOSB joint ventures violating SBA joint-venture rules. • Firm uses the employees from the large firm in the joint ventures to perform the SDVOSB contract work.
5	Septic tank and related services/facilities support services/rental and leasing services Austin, Tex.	\$200,000—Army	<ul style="list-style-type: none"> • Firm and its SDVOSB joint ventures are ineligible for the program because a non-SDVOSB firm performs the work. • Firm and first joint venture were determined ineligible during an SBA bid protest. • After the SBA determination, the non-SDVOSB firm used another SDVOSB joint venture to continue to receive SDVOSB contracts. • Over \$5 million in federal contracts has been obligated to the firm and its SDVOSB joint ventures since SBA ruled the firm and its first SDVOSB joint venture ineligible for the program. • Service-disabled veteran used to qualify for current contracts lives over 1,800 miles from contract-performance location. • SBA determined the firm was ineligible; however, the firm has not been suspended or debarred from receiving federal contracts.
6	Construction/ maintenance/repair/ medical and surgical equipment Burlington, N.J.	\$8.1 million—VA	<ul style="list-style-type: none"> • Firm is ineligible because the service-disabled veteran owner is a full-time New Jersey state employee and does not manage the firm's day-to-day operations. • Our investigation also found that the firm's 49 percent owner, who is not a service-disabled veteran, owns five additional non-SDVOSB construction firms at the same address as the SDVOSB firm receiving contracts. • SBA bid protest initially determined the SDVOSB firm was ineligible because the service-disabled veteran did not own at least 51 percent of the firm. SBA later reversed its decision when the firm submitted revised paperwork.

Case	Industry business location	SDVOSB contracts ^a for years 2003-2009, ^b and awarding agency	Case details
7	Construction/roofing Boise, Idaho	\$3.9 million—VA, Public Buildings Service, Army	<ul style="list-style-type: none"> • Firm is ineligible because a non-service-disabled veteran manages and controls the firm's daily operations. • Our investigation found that the service-disabled veteran is an employee of the firm performing the contract work. • Joint venture was established as a pass-through for a non-SDVOSB roofing firm. • SDVOSB joint venture and non-SDVOSB firm share employees and adjust payrolls to meet program percentage of work requirements. • Service-disabled veteran received only 26 percent of the joint venture's profits.
8	Construction/specialty trade contracting Leominster, Mass.	\$13.8 million—VA, Coast Guard, Army, Public Buildings Service, National Park Service	<ul style="list-style-type: none"> • Firm is ineligible because a non-service-disabled veteran manages and controls the firm's daily operations. • During our investigation, firm executives admitted that the service-disabled veteran is not involved with SDVOSB construction contracts. • Service-disabled veteran is an IT specialist who currently works from home on nongovernment contracts. • All the company construction contracts are managed by the non-service-disabled partner of the firm. • The service-disabled veteran does not receive a salary from the company and received less in IRS 1099 distributions than the 10 percent minority owner of the firm. • Ten percent minority owner of the SDVOSB firm is also the president of another construction company located at the same address as the SDVOSB firm.

Case	Industry business location	SDVOSB contracts ^a for years 2003-2009, ^b and awarding agency	Case details
9	Construction/maintenance/repair Luthersville, Ga.	\$2.8 million—VA, US Coast Guard, USDA, and Army	<ul style="list-style-type: none"> Firm is ineligible because a non-service-disabled veteran manages and controls the firm's day-to-day operations and because the SDVOSB firm is a pass-through for a non-SDVOSB firm. Firm was determined ineligible through an SBA bid protest. Through interviews and our review of documents submitted by the firm, we found that the SDVOSB firm only has four employees and the owner of a non-SDVOSB firm is responsible for day-to-day operations of SDVOSB contracts. The SDVOSB firm submitted 10 joint-venture bids within a 5-month period, violating federal regulations. After being found ineligible by SBA, SDVOSB firm continued to receive approximately \$1.8 million in new SDVOSB contracts. SBA determined the firm was ineligible; however, the firm has not been suspended or debarred from receiving federal contracts.
10	Furniture/merchant wholesaler Tampa, Fla.	\$900,000—Air Force	<ul style="list-style-type: none"> Firm is ineligible because it does not perform any work, and subcontracts 100 percent of the work to non-SDVOSB firms. Our investigation found that the firm's service-disabled veteran owner works full-time as a DOD contract employee at MacDill Air Force Base—the same location as the contract award. SDVOSB firm served as a pass-through to a company where the service-disabled veteran's wife works, who passed the work to a furniture manufacturer who designed, delivered, and installed the furniture. Manufacturer performed planning, design, and installation of contracted goods. This manufacturer is also on the GSA schedule and could have provided the contracted goods at a significantly lower price. The firm's physical address is the owner's home and its mailing address is a mail-box rental store. Contracting officials at MacDill Air Force Base were aware of the pass-through structure of the firm and approved the award knowing that the SDVOSB would not perform the required percentage of work.

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

^aObligation amounts are rounded to the nearest \$100,000.

^bYear 2009 amounts are through July 2009.

SDVOSB Program Does Not Have Governmentwide Fraud-Prevention Controls

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

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

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

Matter for Congressional Consideration

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

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

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

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

GAO Recommendations

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

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

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

Contacts and Acknowledgements

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

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