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Testimony

Before the Subcommittees on Economic  
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Affairs, House of Representatives

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

**Vulnerability to Fraud and  
Abuse Remains**

Statement of Richard J. Hillman, Managing Director  
Forensic Audits and Investigative Service



**G A O**

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Chairmen Stutzman and Johnson, Ranking Members Braley and Donnelly, and Members of the Subcommittees:

I am pleased to be here as you examine the Service-Disabled Veteran-Owned Small Business (SDVOSB) Program's vulnerabilities to fraud and abuse. My remarks today are based on our report, *Service-Disabled Veteran-Owned Small Business Program: Vulnerability to Fraud and Abuse Remains*, recently issued.<sup>1</sup> In fiscal year 2010, federal agencies awarded \$10.8 billion in small-business obligations to firms participating in the SDVOSB program, according to the Small Business Administration (SBA). The program is intended to honor business-owning veterans who incurred or aggravated disabilities in the line of duty by providing their firms with sole-source and set-aside contracting opportunities. Firms must meet several requirements to be eligible to participate in the program, such as being majority-owned by one or more service-disabled veterans who manage and control daily business operations.

SBA administers the government-wide SDVOSB program but does not verify firms' eligibility, stating that its only statutory obligation is to report other agencies' success in meeting contracting goals. In addition to SBA's statutory authority over the government-wide program, the Department of Veterans Affairs (VA) has separate authority over issues related to its own SDVOSB program. VA awarded \$3.2 billion in SDVOSB contracts in fiscal year 2010—about 30 percent of government-wide SDVOSB awards. Unlike SBA, VA is bound by the Veterans Benefits, Health Care, and Information Technology Act of 2006 (2006 Act) to verify firms' eligibility. Since 2009, we have issued 10 reports and testimonies detailing how the government-wide and VA SDVOSB programs are vulnerable to fraud and abuse, making numerous recommendations to strengthen fraud-prevention controls.<sup>2</sup> In October 2010, Congress also passed the Veterans Small Business Verification Act (2010 Act), part of the Veterans' Benefits Act of 2010, to require VA among other things to more-thoroughly validate firms' eligibility before listing them in VetBiz, VA's database of eligible firms. In July 2011, we reported that both SBA and VA had taken positive steps in response to our findings and recommendations, but that vulnerabilities remained.

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<sup>1</sup>[GAO-12-697](#) (Washington, D.C.: Aug. 1, 2012).

<sup>2</sup>See "Related GAO Products" in [GAO-12-697](#).

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You requested that we again update our prior work and report the status of our recommendations. Our report assesses (1) VA's progress in addressing remaining vulnerabilities to fraud and abuse in its SDVOSB program and (2) actions taken by SBA or other federal agencies since our previous reports to improve government-wide SDVOSB fraud-prevention controls. To do so, we reviewed agency documentation and interviewed agency officials. We investigated new allegations from informants regarding firms that received SDVOSB contracts through fraudulent or abusive eligibility misrepresentation and highlighted 5 examples. Our examples cannot be projected to the overall population of SDVOSB firms. We also reviewed the status of 10 case studies from our prior work. We did not project the extent of fraud and abuse in the program. We conducted this performance audit from January 2011 to July 2012 in accordance with generally accepted government auditing standards.<sup>3</sup> 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 audit objectives. We performed our investigative work from January 2011 to July 2012 in accordance with the standards prescribed by the Council of the Inspectors General on Integrity and Efficiency.

In summary, VA's SDVOSB program remains vulnerable to fraud and abuse. VA has made inconsistent statements about its progress in verifying firms listed in VetBiz using the new, more-thorough process the agency implemented in response to the 2010 Act. In one communication, VA stated that as of February 2011, all new verifications would use the 2010 Act process going forward. According to the most-recent information provided by VA, there are 6,079 SDVOSBs and veteran-owned small

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<sup>3</sup>Some of the work in this report is based on prior GAO products issued in 2012, 2011, and 2009. GAO, *Service-Disabled Veteran-Owned Small Business Program: Governmentwide Fraud Prevention Control Weaknesses Leave Program Vulnerable to Fraud and Abuse, but VA Has Made Progress in Improving Its Verification Process*, [GAO-12-443T](#) (Washington, D.C.: Feb. 7, 2012); *Service-Disabled Veteran-Owned Small Business Program: Additional Improvements to Fraud Prevention Controls Are Needed*, [GAO-12-205T](#) (Washington, D.C.: Nov. 30, 2011); *Service-Disabled Veteran-Owned Small Business Program: Preliminary Information on Actions Taken by Agencies to Address Fraud and Abuse and Remaining Vulnerabilities*, [GAO-11-589T](#) (Washington, D.C.: July 28, 2011); and *Service-Disabled Veteran-Owned Small Business Program: Case Studies Show Fraud and Abuse Allowed Ineligible Firms to Obtain Millions of Dollars in Contracts*, [GAO-10-108](#) (Washington, D.C.: Oct. 23, 2009).

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businesses (VOSB) listed in VetBiz. Of these, 3,724 were verified under the more-through process implemented under the 2010 Act, and 2,355—over 38 percent—were verified under the less-rigorous 2006 Act process. The presence of firms that have only been subjected to the less-stringent process that VA previously used represents a continuing vulnerability.<sup>4</sup> In 2011, VA’s Office of Inspector General (OIG) issued a report finding that VA’s document review process under the 2006 Act “in many cases was insufficient to establish control and ownership ... [and] in effect allowed businesses to self-certify as a veteran-owned or service-disabled veteran-owned small business with little supporting documentation.”

VA has taken some positive action to enhance its fraud-prevention efforts. VA generally concurred with recommendations we issued in October 2011 and has established processes in response to 6 of the 13 recommendations (fig. 1). VA has also begun action on some remaining recommendations, such as providing fraud-awareness training and removing contracts from ineligible firms, though these procedures need to be finalized.

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<sup>4</sup>On June 27, 2012, VA implemented an interim rule that extends the eligibility of verified firms to 2 years. VA told us it interprets “verified” to include any firms that have been verified under either the 2006 Act or 2010 Act processes. Consequently, implementation of this rule means that thousands of firms will continue to be eligible for contracts even though they have not undergone the more-thorough 2010 Act process.

**Figure 1: Status of GAO's Previous Recommendations**

Fraud-prevention controls	GAO recommendations	Status as of June 2012
<b>Preventive</b>	Provide regular fraud-awareness training to CVE <sup>a</sup> and VA contracting personnel	○
	Provide additional guidance and training to the VA contracting personnel on the use of the VetBiz website so that SDVOSB contracts are only awarded to verified firms	●
	Establish formal procedures for VA staff to refer suspicious applications to the OIG and provide guidance on what type of cases to refer to the OIG	●
	Explore the feasibility of validating applicants' information with third parties, for example, requesting consent from SDVOSB applicants to validate tax information with the IRS to assess the accuracy of the information provided	●
	Formalize a process for conducting unannounced site visits to firms identified as high risk during the verification process	●
<b>Detection and Monitoring</b>	Develop and implement procedures for conducting unannounced site visits to contract performance locations and interviews with contracting officials to better assess whether verified companies comply with program rules after verification	○
	Develop and implement a process for unannounced site visits to verified companies' offices to obtain greater effectiveness and consistency in the verification program	●
	Develop procedures for risk-based periodic reviews of verified firms receiving contracts to assess compliance with NAICS <sup>b</sup> size standards and SDVOSB program rules	○
<b>Investigations and Prosecutions</b>	Develop and implement specific processes and criteria for the Debarment Committee <sup>c</sup> on compliance with the requirement in the 2006 Act to debar, for a reasonable period of time, firms and related parties that misrepresent their SDVOSB status	○
	Develop and implement specific procedures and criteria for staff to make referrals to VA's Debarment Committee and VA's OIG as a result of misrepresentations identified during initial verification and periodic reviews	●
	Develop specific guidelines outlining the Debarment Committee's decision process to debar firms that misrepresent their SDVOSB status	○
	Develop procedures on removing SDVOSB contracts from ineligible firms	○
	Formalize procedures to advertise debarments and prosecutions	○

- Process established
- Process not established

Source: GAO and analysis of VA data.

<sup>a</sup>VA's Center for Veterans Enterprise (CVE) is responsible for maintaining VetBiz and implementing VA's verification program.

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<sup>b</sup>The North American Industry Classification System (NAICS) is the standard used by federal statistical agencies in classifying business establishments for the purpose of collecting, analyzing, and publishing statistical data related to the U.S. business economy.

<sup>c</sup>VA's Debarment Committee was instituted in September 2010 specifically to debar firms that had violated SDVOSB regulations.

Regarding the government-wide SDVOSB program, no action has been taken by agencies to improve fraud-prevention controls. Relying almost solely on firms' self-certification, the program continues to lack controls to prevent fraud and abuse. For example, the Department of Defense (DOD) OIG reported in 2012 that DOD provided \$340 million to firms that potentially misstated their SDVOSB status. SBA does not verify firms' eligibility status, nor does it require that they submit supporting documentation. While SBA is under no statutory obligation to create a verification process, five new cases of potentially ineligible firms highlight the danger of taking no action. These firms, discussed below, received approximately \$190 million in SDVOSB set-aside and sole-source contract obligations.

- *Non-SDVOSB joint venture.* An SDVOSB entered a joint venture with a non-SDVOSB firm and received about \$16 million in government-wide SDVOSB set-aside contract obligations. However, the owner, a service-disabled veteran, admitted to our investigators that his SDVOSB firm did not manage the joint venture.
- *VA-denied firm.* Though VA denied this firm SDVOSB status in 2010 because the firm was not controlled by a service-disabled veteran owner, it continued to self-certify in the Central Contractor Registration (CCR).<sup>5</sup> The firm had received \$21 million in SDVOSB set-aside and sole-source contracts from multiple agencies, and was awarded about \$860,000 by the General Services Administration and the Department of the Interior (DOI) after it was denied by VA.
- *Multiple firms not veteran-controlled.* Two firms and a joint venture firm received over \$91 million in SDVOSB set-aside and sole-source contract obligations from VA and the Department of Health and Human Services. However, VA determined they were ineligible because they were not controlled by the service-disabled veteran who

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<sup>5</sup>CCR 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.

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owned one of the firms. The firms have not been removed from the government-wide SDVOSB list.

- *Not service-disabled veteran-controlled.* This firm was ineligible for the SDVOSB program because the veteran did not control daily operations—he lived 500 miles away and received only a \$12,000 salary. This firm received about \$37 million in SDVOSB set-aside contract obligations from DOD and DOI. SBA has since debarred the firm from the program.
- *Service-disabled veteran otherwise employed.* The firm may be ineligible because the service-disabled veteran owner worked as an attorney at a legal services organization Monday through Friday about 40 hours a week. This raises questions about his ability to also manage the day-to-day proceedings of the SDVOSB firm, which received about \$25 million in SDVOSB set-aside and sole-source contract obligations from VA and the Department of Transportation.

The firms in our previous 10 case studies that we reported in October 2009 have been or are under investigation by the SBA OIG. The SBA OIG has joined forces with other agency OIGs to pursue several cases. For example, enforcement actions have been taken against 3 of the 10 cases. Specifically, two individuals related to our cases have been charged with wire fraud in relation to their misrepresentation as an SDVOSB and another firm pled guilty to wire fraud in relation to another small-business program.

To address vulnerabilities in the government-wide program, we previously suggested that Congress consider providing VA with the authority necessary to expand its SDVOSB eligibility-verification process government-wide. Such an action is supported by the fact that VA maintains the database identifying which individuals are service-disabled veterans and is consistent with VA's mission of service to veterans. However, as shown by our current work, VA's program remains vulnerable to fraud and abuse because the agency has been unable to accurately track the status of its efforts and because potentially ineligible firms remain listed in VetBiz. Consequently, VA's ability to show that its process is successful in reducing the SDVOSB program's vulnerability to fraud and abuse remains an important factor in any consideration about the potential expansion of VA's eligibility verification process government-wide.

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To minimize potential fraud and abuse in VA's SDVOSB program and provide reasonable assurance that legitimate SDVOSB firms obtain the benefits of this program, we recommend in our newly issued report that the Secretary of Veterans Affairs ensure that all firms within VetBiz have undergone the 2010 Act verification process. Specifically, this should include consideration of the following three actions: (1) inventory firms listed in VetBiz to establish a reliable beginning point for the verification status of each firm; (2) establish procedures to maintain the accuracy of the status of all firms listed in VetBiz, including which verification process they have undergone; and (3) expeditiously verify all current VetBiz firms and new applicants under the more-thorough 2010 Act verification procedures.

VA generally concurred with our recommendations but expressed concern about how specific report language characterized its program. GAO made some changes to the report as appropriate but continues to believe that the program remains vulnerable to fraud and abuse. In written comments, SBA stated that it is committed to eliminating fraud, waste, and abuse in all of its programs including the government-wide SDVOSB program.

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Mr. Chairmen, Ranking Minority Members, and Members of the Subcommittees, this concludes my prepared remarks. I would be happy to answer any questions that you or other members of the subcommittees may have.

For additional information about this testimony, please contact Richard J. Hillman at (202) 512-6722 or [hillmanr@gao.gov](mailto:hillmanr@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Other key contributors to this statement include Jennifer Costello, Assistant Director; Arturo Cornejo; Gloria Proa; Abby Volk; and Timothy Walker.



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