

**STATEMENT OF
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OFFICE OF INSPECTOR GENERAL
DEPARTMENT OF VETERANS AFFAIRS
BEFORE THE
SUBCOMMITTEE ON TECHNOLOGY, INFORMATION POLICY,
INTERGOVERNMENTAL RELATIONS, AND PROCUREMENT REFORM
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES
HEARING ON
“SERVICE DISABLED VETERAN OWNED BUSINESS PREFERENCE
IN FEDERAL PROCUREMENT”
FEBRUARY 7, 2012**

Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to discuss the Office of Inspector General's (OIG) work related to the Department of Veterans Affairs' (VA) Veteran-Owned and Service-Disabled Veteran-Owned Small Business (VOSB and SDVOSB) programs. Last summer, we issued a report, *Audit of Veteran-Owned and Service-Disabled Veteran-Owned Small Business Programs*, that found that 76 percent of businesses we reviewed were ineligible for either the program and/or the specific VOSB or SDVOSB contract award, potentially resulting in \$2.5 billion awarded to ineligible businesses over the next 5 years. I am accompanied by James J. O'Neill, Assistant Inspector General for Investigations. To date his office's work has resulted in the conviction of one company official for falsely self-certifying a business as an eligible VOSB and SDVOSB, and three additional investigations have resulted in criminal charges against six individuals and one company. We are actively pursuing 87 investigations.

BACKGROUND

On December 22, 2006, Public Law (PL) 109-461, *Veterans Benefits, Health Care, and Information Technology Act of 2006*, established participation goals and other requirements to increase VA contracting opportunities for veteran-owned small businesses. VA implemented these requirements by establishing the Veterans First Contracting program. The program placed SDVOSBs and VOSBs first and second in VA's hierarchy of socioeconomic contracting preferences and required businesses to register in VA's VetBiz Vendor Information Pages (VIP) to be eligible for contract awards. VetBiz VIP is VA's congressionally-mandated database of businesses that are eligible to participate in its VOSB and SDVOSB programs. VA's Office of Small and Disadvantaged Business Utilization (OSDBU) monitors VA's implementation and execution of socioeconomic programs, including the VOSB and SDVOSB contracting programs. The Center for Veterans Enterprise (CVE) within OSDBU verifies the eligibility of veteran-owned businesses and maintains VetBiz VIP as required by PL 109-461. VA is the only agency within the Federal government that verifies the status of veteran-owned businesses participating in its VOSB and SDVOSB programs.

With the introduction of the Veterans First Contracting program, VA's VOSB and SDVOSB programs have grown significantly from \$2.1 billion in fiscal year (FY) 2008 to \$3.5 billion in both FY 2010 and FY 2011, an increase from 15 to 23 percent of VA's total procurement dollars. The VOSB and SDVOSB contracting programs increase contracting and subcontracting opportunities for veterans and service-disabled veterans and ensure these businesses receive fair consideration when VA purchases goods and services.

The growth in the VOSB and SDVOSB programs has also spurred growing concerns that veteran-owned businesses may not be receiving the full benefit of these contracting programs. As a result, the OIG performed an audit of the VOSB and SDVOSB programs and began investigating an increasing number of referrals alleging that businesses had misrepresented themselves as veteran-owned businesses to obtain VA contracts. Our audit work disclosed that VA had awarded numerous VOSB and SDVOSB sole-source and set-aside contracts to businesses that did not meet program and contract requirements. In addition, we are pursuing numerous other investigations involving alleged "pass throughs" where a VOSB wins a contract, performs little to none of the work, and passes through the contract to an ineligible company for a fee or percentage of the award.

AUDIT OF THE VOSB AND SDVOSB PROGRAMS

In our report, *Audit of the Veteran-Owned and Service-Disabled Veteran-Owned Small Business Programs* (July 25, 2011), we examined VA's VOSB and SDVOSB programs to determine if businesses that received contracts under these programs met program and contract eligibility requirements and if program controls were effective. We found that 76 percent of the businesses we reviewed were ineligible for either the program and/or the specific VOSB or SDVOSB contract award. From the 42 statistically selected businesses we reviewed, 32 ineligible businesses received \$46.5 million in VOSB and SDVOSB contracts. These awards included \$26.7 million in Recovery Act funded contracts.

We projected that VA annually awarded at least 1,400 VOSB and SDVOSB sole-source and set-aside contracts valued at \$500 million to ineligible businesses and that it would award a minimum of \$2.5 billion over the next 5 years if VOSB and SDVOSB verification and program controls were not strengthened. Further, the award of VOSB and SDVOSB contracts to ineligible businesses reduced the funding available to eligible businesses and the accuracy of VA's reported socioeconomic goal accomplishment data. For FY 2010, OSDDBU reported that VA procurements totaled \$15.4 billion, of which \$3.5 billion went to VOSBs and of that \$3.5 billion, \$3 billion went to SDVOSBs. Our audit results indicate that VA awarded somewhere between \$500 million to \$2.6 billion in VOSB and SDVOSB contracts to ineligible businesses during a 12-month period. If we adjust the goal data for our findings, VA's reported FY 2010 VOSB and SDVOSB procurement dollars would decrease somewhere between 3 to 17 percent. VA, in reality, may be barely meeting the Secretary's VOSB and SDVOSB procurement goals of 12 and 10 percent.

PROGRAM AND CONTRACT ELIGIBILITY DEFICIENCIES

The audit reported two major areas of risk in VA's assessment of VOSB and SDVOSB eligibility: the verification of ownership and control to establish the eligibility of the business for the programs and the review of subcontracting and partnering agreements at the time of award to establish the eligibility of the business for the contract. We found that veterans either did not own or control the businesses or veteran-owned businesses "passed through" or subcontracted more work to nonveteran-owned businesses than allowed under Federal regulations. In some instances, businesses had multiple ownership, control, and subcontracting issues that made them ineligible.

Veterans Did Not Own or Control Businesses

Thirty-eight percent of the reviewed businesses were ineligible for the programs because veterans did not own and/or control the businesses. Sixteen ineligible businesses improperly received 28 VOSB and SDVOSB sole-source and set-aside contracts valued at \$8.5 million. To be eligible for the programs, Title 38, Code of Federal Regulations (CFR), Part 74.1, requires one or more veterans or service-disabled veterans to unconditionally and directly own at least 51 percent of the business and to manage and control the operations of the business concern. Further, veterans must be involved in long-term decision-making and day-to-day management of the business operations, hold the highest officer position in the business (president or chief executive officer), and must have managerial experience commensurate with the extent and complexity needed to operate the business.

In many cases, the self-certifications for the businesses on VetBiz VIP, the Central Contractor Registration (CCR), the Online Representations and Certifications Application, and other documents indicated a veteran owned the business. However, 2 of the 16 businesses that CVE had previously verified as eligible for the program through their review of available online documents such as the CCR, Dun and Bradstreet reports, and obligation amounts from the USA Spending Web site, were, in fact, ineligible. Our interviews and observations often showed that business managers or nonveteran family members managed, operated, and controlled the day-to-day business operations. We concluded that online document reviews were insufficient to establish program eligibility and ensure businesses meet Federal ownership and control requirements. Instead, we believe interviews with veteran owners and business managers and the review of documents such as corporate bylaws, stock certificates, tax returns, resumes, and negotiated checks during onsite visits are critical to establishing a veteran's ownership and control of a business. For example, in the case of an SDVOSB that provided VA duct cleaning and maintenance services, reviews of key documents, such as the past 3 years of tax returns, showed that the veteran's spouse received 100 percent of the business' profits and owned the business instead of the veteran.

Businesses "Passed Through" Contracts or Did Not Meet Subcontracting Requirements

Fifty-seven percent of the reviewed businesses were ineligible for the awarded VOSB and SDVOSB contracts because the businesses did not meet Federal incurred cost and subcontracting performance thresholds. The 24 ineligible businesses received

57 VOSB and SDVOSB sole-source and set-aside contracts valued at \$39.3 million. Federal regulations at 13 CFR 125.6(b) and 48 CFR 52.219-27(c) prescribe thresholds and limitations on subcontracting for VOSB and SDVOSB contracts. For service contracts, the VOSB or SDVOSB must incur at least 50 percent of the cost of the contract using its own employees. For general construction contracts, the VOSB or SDVOSB must incur at least 15 percent of the cost of the contract using its own employees. In addition, VOSBs and SDVOSBs are required to submit partnering agreements with their bid proposals so contracting officers can review them prior to award.

Despite these requirements, 18 businesses with 42 VOSB and SDVOSB contracts valued at \$35 million had passed through the majority of the contracts' work requirements and funds to nonveteran-owned businesses. Pass through contracts occur when businesses or joint venture/partnerships list veterans or service-disabled veterans as the majority owners of the business, but the nonveteran-owned business either performs or manages the majority of the work and receives the majority of the contracts' funds. Six additional businesses with 15 SDVOSB contracts valued at \$4.3 million also exceeded the VOSB and SDVOSB subcontracting thresholds or limitations established in Federal regulations. These thresholds deter pass through arrangements because they limit the amount of work that can be subcontracted to other businesses and establish the minimum amount of work to be completed by the veteran-owned business. All 24 of the businesses generally lacked the technical expertise and/or the resources to complete the required amount of work on the contracts. For example, the resume of a veteran-owner of an SDVOSB showed that he lacked the technical expertise to manage and control a construction business because he had no experience in construction. Instead, the veteran-owner's resume indicated that he had 31 years of experience in the banking industry where he served as a senior officer, president, and CEO of various financial organizations.

From our discussions with business owners, we concluded that these types of subcontracting agreements were common practice. VOSBs and SDVOSBs solicit partnerships with nonveteran-owned businesses that possess the technical capability to do the work. Likewise, ineligible nonveteran-owned businesses initiate relationships with VOSBs and SDVOSBs to gain access to Federal VOSB and SDVOSB contracts. We believe partnerships and mentoring relationships between VOSBs, SDVOSBs, and other businesses are valuable in promoting the development and advancement of veteran-owned businesses. However, VOSBs and SDVOSBs need to adhere to Federal incurred cost and subcontracting performance requirements. This will ensure, in keeping with the goals of the VOSB and SDVOSB socioeconomic programs, that eligible businesses perform the specified amount of contract work and receive a commensurate amount of the funds and benefits from the contract awards.

VOSBs Improperly Used the SDVOSB Status Preference

Two VOSBs also improperly used the service-disabled veteran preference to obtain 13 set-aside and sole source contracts valued at \$5.6 million. To be eligible for SDVOSB contracts, the Federal regulations define a service-disabled veteran as a

veteran with a VA service-connected disability rating between 0 and 100 percent. The veteran owners of these two businesses self-certified in the CCR and VetBiz VIP that they had service-connected disabilities and requested CVE verification to participate in the SDVOSB program. CVE could not verify the claimed service-connected disabilities in the Veterans Benefits Administration's Beneficiary Identification Records Locator Subsystem and sent letters to the two businesses informing the veteran owners that it could not verify that they were service-connected veterans. At that time, legislation allowed CVE to accept the businesses' self-certifications and did not require CVE to remove businesses from the VetBiz VIP database. Because CVE did not remove these two businesses from view in the VetBiz VIP database, the VOSBs improperly benefitted from the receipt of SDVOSB contracts and potentially blocked eligible SDVOSBs from receiving these contracts.

FACTORS CONTRIBUTING TO AWARDS TO INELIGIBLE BUSINESSES

Several factors within VA facilitated the award of VOSB and SDVOSB contracts to ineligible businesses. In general, OSDBU lacked the management controls needed to effectively oversee the VOSB and SDVOSB programs, to ensure the effectiveness of CVE verification processes, and to coordinate the oversight of contracting officers with VA's major acquisition offices. Inadequate OSDBU program oversight and the lack of coordination with VA's Office of Acquisition and Logistics (OA&L) and the Veterans Health Administration's (VHA) Procurement and Logistics Office (P&LO) contributed to the improper award of VOSB and SDVOSB contracts to ineligible businesses. OSDBU's coordination with VA's acquisition community should have addressed issues such as the need to review VOSB and SDVOSB subcontracting and partnering agreements that can result in pass-throughs to nonveteran-owned businesses.

OSDBU Lacked Effective Management Controls

OSDBU and CVE lacked a formal organizational structure and an accurate, updated organizational chart. Further, staff performing business verifications lacked documented duties, roles, and responsibilities and some staff lacked job descriptions that accurately described their current job functions. In addition, OSDBU and CVE did not have current policies and procedures for the administration of the verification program. CVE had last updated its verification program policies and procedures in August 2009. Thus, its policies and procedures did not address changes in VetBiz VIP and revised verification processes needed to comply with the *Veterans Benefits Act of 2010* (PL 111-275). On April 15, 2011, CVE issued updated internal policies and procedures for its verification processes. At the time of our audit, neither OSDBU nor CVE had yet developed additional guidance needed for management oversight functions such as accountability for the completion of assigned verification duties and responsibilities and the establishment of verification performance measures and reporting requirements.

Finally, at the time of our audit, OSDBU and CVE lacked an effective performance management system to effectively monitor and evaluate staff performance and CVE business verification processes. OSDBU and CVE's weekly performance monitoring meetings focused on the progress made on the verifications but did not address the

timeliness and quality of staff performance and verifications and the maintenance of VetBiz VIP data. In conclusion, we found OSDDBU lacked the management processes needed to determine if it has the right staff, resources, and processes in place to timely implement and monitor current VOSB and SDVOSB program requirements and possible future process improvements.

CVE Lacked Effective Verification Processes

CVE verification processes needed strengthening to reduce the number of ineligible businesses participating in the programs. In the past CVE's verification processes consisted of limited electronic document reviews to assess ownership and control and the selective completion of onsite reviews for businesses deemed high-risk. This verification process allowed businesses to self-certify as VOSBs or SDVOSBs with little supporting documentation and little chance of an onsite review. At the same time, CVE did not properly maintain the VetBiz VIP database. For example, CVE staff did not remove a business from VetBiz VIP after OSDDBU sustained a protest of the business' veteran-owned status, thus allowing the ineligible business to continue receiving VOSB and SDVOSB sole-source and set-aside contracts.

Laws and regulatory changes enacted since May 2010 (the end period for the obligation amounts and businesses in our sample that we reviewed) now require CVE to verify each small business concern listed in the VetBiz VIP database to ensure a veteran or a service-disabled veteran owns and controls the business. Further, as of September 2010, all prospective VOSB and SDVOSB awardees are required to apply and undergo verification by CVE prior to receiving a contract award. To comply with these requirements, CVE initiated a Fast Track program to verify businesses with pending awards within 21 business days, implemented additional verification documentation requirements, and notified businesses of the new requirements. The additional document reviews CVE has recently implemented have stopped businesses from self-certifying as VOSBs and SDVOSBs and required the businesses to provide evidence of veteran ownership. However, OSDDBU and CVE did not have strategies and risk analyses to better identify high-risk businesses, and conduct onsite reviews when they identify high-risk or potentially ineligible businesses.

Contracting Officers Lacked Oversight When Awarding VOSB and SDVOSB Contracts

OSDBU's lack of program oversight and coordination with OA&L and P&LO also contributed to the high number of ineligible businesses awarded VOSB and SDVOSB sole-source and set-aside contracts. OSDDBU did not coordinate the monitoring of contracting officers with OA&L and P&LO to ensure they complied with VOSB and SDVOSB contracting requirements. As a result, contracting officers did not adequately assess the eligibility of the business for the VOSB and SDVOSB contracts as required by the Federal Acquisition Regulation and VA Acquisition Regulation during the contract award process. Fifty-seven percent of the reviewed businesses were ineligible for \$39.3 million in VOSB and SDVOSB contracts because contracting officers either did not review or properly assess the businesses' subcontracting and partnering agreements at the time of award. Moreover, contracting officers often did not check VetBiz VIP or the business' North American Industry Classification System codes

assigned by the Small Business Administration (SBA) to ensure businesses met program and size eligibility requirements.

ELIGIBILITY AND CONTRACTING DEFICIENCIES IN RECOVERY ACT CONTRACTS

We also reported that 14 of the 42 statistically selected businesses had received 24 VOSB and SDVOSB contracts funded with \$27.3 million from the American Recovery and Reinvestment Act. We noted that 13 of the 42 businesses had improperly received \$26.7 million in VOSB and SDVOSB contracts funded by the Recovery Act. As discussed previously, these businesses were ineligible due to a lack of demonstrated ownership and/or control, improper subcontracting practices, improper use of SDVOSB status, or a combination of these factors. Contracting officers also awarded 9 businesses 10 VOSB and SDVOSB Recovery Act contracts valued at \$5.3 million that had at least one contracting deficiency.

REPORT RECOMMENDATIONS AND ACTION PLANS

We recommended VA and OSDDBU implement effective management and program controls, enhance verification processes, and implement a coordinated contract monitoring activity for VOSB and SDVOSB contracts to ensure the long-term success of the VOSB and SDVOSB programs. The Deputy Under Secretary for Health, the Executive Director of the Office of Small and Disadvantaged Business Utilization, and the Executive Director of the Office of Acquisition, Logistics, and Construction agreed with our report's findings and recommendations and provided acceptable action plans. Nevertheless, VA will need to address P&LO, OA&L, and OSDDBU's shared and interrelated responsibilities in administering and overseeing VA's VOSB and SDVOSB programs as it develops an enterprise-wide strategy to reduce the number of ineligible businesses receiving contract awards. The effectiveness, and ultimately the success, of an enterprise-wide strategy will depend on OSDDBU, P&LO, and OA&L's continued collaboration, coordination, and follow through on the planned corrective actions.

VA has reported that action on two of the six recommendations is complete.

- The establishment of an oversight function to ensure the completion of site visits for all VOSBs and SDVOSBs identified by CBVE as high risks to ensure that they meet Federal requirements for control, ownership, and program eligibility.
- The establishment of a comprehensive management control system, a performance management system, and the update of policies and procedures to ensure the effective administration of the VOSB and SDVOSB programs

We will continue to monitor the implementation and coordination of the offices' respective action plans as we follow up on the report's recommendations and monitor the VOSB and SDVOSB programs.

OIG INVESTIGATIVE WORK RELATED TO VOSBs AND SDVOSBs

The OIG's Office of Investigations is aggressively pursuing allegations and referrals regarding ineligible businesses that obtain VOSB and SDVOSB contract awards. As of January 2012, we have 87 open investigations and have issued approximately 369

subpoenas and executed 26 search warrants. Our efforts have resulted in the conviction of one business official and an additional six individuals and one company have been charged. We anticipate additional prosecutions in the future.

Most of our investigations involve “pass through” schemes where an ineligible large business has allegedly created an SDVOSB with the assistance of a service-disabled veteran. The SDVOSB owned by the service-disabled veteran then wins SDVOSB sole-source and set-aside contract awards, but does not perform any of the work. The SDVOSB simply functions as a shell business and “passes through” the work to the ineligible large business. Details from recent investigations include:

The CEO of a construction management and general contracting business, that received SDVOSB set-aside construction contracts, was convicted of committing fraud against the United States, mail fraud, witness tampering, and making false statements. An OIG joint investigation with SBA OIG and the Army Criminal Investigations Division revealed that the CEO falsely self-certified that his business was an eligible VOSB and SDVOSB in order to obtain over \$16 million in contracts from these programs. During the investigation, the defendant made false statements to a Federal agent claiming that another person who had served in the military was the majority owner of his business. He is awaiting sentencing, but he and the company have been debarred from doing business with the Federal government.

A company and four individuals were indicted on charges of conspiracy to defraud the Government, major program fraud, wire fraud, conspiracy to commit money laundering, and false statements. An OIG joint investigation with SBA OIG, General Services Administration OIG, and Defense Criminal Investigative Service determined that the SDVOSB acted as a pass-through company for a larger company and that the owner of the SDVOSB was not a service-disabled veteran.

An individual was charged with conspiracy to commit wire fraud and major fraud against the United States. An OIG investigation determined that the veteran agreed to allow a company to use his name and service-disabled status to be awarded VA SDVOSB set-aside contracts.

An individual was charged with 14 counts of wire fraud and one count of major program fraud after an OIG joint investigation with SBA OIG, U.S. Department of Agriculture OIG, and Department of Homeland Security OIG determined that the individual approached a Vietnam War veteran, who was bedridden from multiple surgeries related to his war injuries, and proposed the idea of starting a joint venture that would use the veteran’s disabled status to obtain Federal contracts that are set aside for SDVOSBs. The individual used the veteran’s status to bid on contracts, all of which were reserved for small businesses owned and operated by service-disabled veterans. The veteran performed no work for either company, did not have an ownership stake, and did not control the management or daily operations of either business.

CONCLUSION

To fix the problems identified, VA must ensure that legitimate veteran-owned businesses are receiving the contracts intended for them. VA is currently the only Federal agency that verifies the status of veteran-owned businesses, yet many contracts are still going to companies that are ineligible for the program or do not meet the specific contract requirements. VA is taking actions to strengthen its CVE verification and its contracting practices. Collaboration between OSDDBU, OA&L, and P&LO in the development of a management control system for VA's VOSB and SDVOSB procurements should promote the participation of eligible businesses and ensure VA has adequate VOSB and SDVOSB program and contract oversight from the time of award through contract performance. We will monitor the implementation of VA's corrective actions and perform follow-up work to assess the effectiveness of the future verification and contracting practices.

Mr. Chairman, thank you for the opportunity to discuss the OIG's work related to VA's VOSB and SDVOSB programs. We would be pleased to answer any questions that you or other members of the Subcommittee may have.

Belinda J. Finn
Assistant Inspector General for Audits and Evaluations

Belinda J. Finn joined the Office of Inspector General at the Department of Veterans Affairs in January 2007. During her career as a government auditor and analyst, Ms. Finn has worked for both the executive and legislative branches of the federal government, starting as an administrative employee for the United States Air Force and Internal Revenue Service. Before joining VA, Ms. Finn was a Deputy Assistant Inspector General for the Department of Homeland Security. Her earlier experience included work as an accountant and auditor with the Department of Treasury, Bureau of Public Debt, Naval Audit Service, Department of Defense Inspector General, Department of Energy Inspector General, and U.S. House of Representatives Inspector General.

In 1981, Belinda graduated Summa Cum Laude degree from the University of Maryland, College Park, with a Bachelor of Science degree in accounting. In 2002, she earned a Master of Science in Information Resource Management from the University of Maryland, University College. She is a former fellow with the Council for Excellence in Government and has earned certifications as a Certified Public Accountant, Certified Internal Auditor, Certified Government Financial Manager and Certified Information Systems Auditor.

Belinda is a member of Institute of Internal Auditors, and the Association of Government Accountants. She resides in Arlington, Virginia with John (husband) and Chester (cat).

James J. O'Neill
Assistant Inspector General for Investigations

In July 2006, Jim O'Neill was appointed Assistant Deputy Inspector General for Investigations (AIG) after serving nearly 3 years as Deputy AIG. He is responsible for planning and directing investigations of alleged criminal activities related to VA programs and operations, as well as allegations of non-criminal misconduct committed by senior VA officials. He personally led the criminal and administrative investigations of the Montgomery County data loss in May 2006.

From 1999 until 2003, Mr. O'Neill served as the OIG's Chief Information Officer where he led efforts to modernize the information technology program, which culminated in the successful deployment of the OIG's first corporate management information system, the Master Case Index.

Prior to joining the OIG in 1999, Mr. O'Neill completed a successful 23-year career with the U.S. Secret Service as Deputy Assistant Director for the Office of Training. In 1997, he was appointed as Special Agent in Charge of the Forensic Services Division and led the successful effort to gain the lab's first accreditation by the American Society of Crime Lab Directors. Since 1988, he held managerial positions in a variety of investigative, protective, and information technology divisions. He served as a Special Agent in the Philadelphia Field Office and the Presidential Protective Division, and as an instructor in the Office of Training.

In 1971, Mr. O'Neill earned a B.A. degree in Political Science from La Salle University in Philadelphia, PA. Prior to joining the U.S. Secret Service, he was employed as a high school teacher in Philadelphia Public Schools. He is the married father of three and grandfather of four.

In 2008, Jim received a Presidential Rank Award for Meritorious Service.