



**STATEMENT OF PEGGY E. GUSTAFSON, INSPECTOR GENERAL
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**BEFORE THE SMALL BUSINESS AND
ENTREPRENEURSHIP COMMITTEE, UNITED STATES SENATE
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Introduction:

Chair Landrieu, Ranking Member Snowe, and distinguished members of the Committee, thank you for giving the Small Business Administration (SBA) Office of Inspector General (OIG) the opportunity to discuss some of our current activities.

As you know, I head an independent office established within SBA by statute to deter and detect waste, fraud, abuse and inefficiencies in SBA programs and operations. Every year, our staff of approximately 110 employees, which includes criminal investigators, auditors, attorneys, and program analysts, conducts numerous criminal investigations to identify fraud and other wrongdoing throughout the country, and issues dozens of audit reports identifying weaknesses and deficiencies in SBA programs and operations.

Based upon discussions with Committee staff, I understand that the Committee's interest in my testimony is primarily to learn about fraud in SBA preferential contracting programs (such as the Section 8(a), HUBZone, Service-Disabled Veteran-Owned (SDVO) and Woman-Owned Business Programs), and problems we have identified with SBA's management of these programs, so the Committee can assess whether these factors restrict minority access to contracting opportunities. That will be the focus of my testimony today, although I am happy to answer any questions about the SBA OIG's work in SBA loan and other programs.

Criminal and Civil Fraud Cases and Administrative Enforcement Actions

The OIG is very concerned about continued fraud and improper activity in the 8(a), SDVO, HUBZone Programs and other preferential contracting programs, identified through OIG audits and investigations and recent reports from the Government Accountability Office. Most of our investigations of procurement fraud involve false statements by those who seek to exploit SBA programs for their personal gain by either: (1) falsely claiming to meet eligibility criteria; or (2) fraudulently using an eligible business as a "pass-through" so that an ineligible company will actually perform the work and receive most of the profits. If ineligible companies improperly profit from preferential contracting through fraud and illegal conduct, legitimate companies necessarily have fewer opportunities to benefit from these programs.

For example, in one recent case, the owner of a Georgia firm pled guilty to making false statements to get into the 8(a) Program by concealing the involvement of her former employer, who was not a socially and economically disadvantaged person, in the management and operations of her firm. Her false statements resulted in SBA certifying her firm as an 8(a) company and allowing it to obtain 8(a) set-aside contracts valued at about \$5.4 million.

As another example, in the SDVO program, an investigation that we participated in recently resulted in the indictment of a man for making false statements. He is alleged to have falsely claimed SDVO status for his company, resulting in the award of four set-aside contracts totaling over \$16 million.

In the HUBZone program, we have investigated applicants who falsely claimed to meet the requirement to have their principal office located in an SBA-certified HUBZone. In other cases, firms have not met the requirement that 35% of its employees live in the HUBZone, but a lack of clear regulatory language hampers our ability to pursue this issue. Other cases have involved HUBZone firms not performing the required percentage of work on a contract or acting as a “pass-through” for large businesses. Working with the Department of Justice’s Civil Fraud Section, we have had recent success in pursuing False Claims Act cases against several HUBZone-certified companies for falsely statements regarding their principal office location. These cases resulted in the civil recovery of \$1.3 million. Recovery in these cases has been hindered, however, because, although some of these companies received millions of dollars in contracts, they spent the money and had few assets to satisfy a judgment.

As a complement to criminal prosecution and civil fraud recovery, the SBA OIG works to promote the suspension and debarment of contractors from all procurement and other non-entitlement governmental programs for fraudulent and improper conduct. From FY 2009 to today, the SBA OIG has referred twenty-six contractors for suspension or debarment. Among cases that my office has assisted on, SBA took the aggressive action last fall to suspend GTSI and two other contractors that were involved in pass-through contracts issued by the Department of Homeland Security. Although the SBA OIG commends the Agency for taking this strong action, we believe that SBA could be more proactive in pursuing debarments and other enforcement activity against those who wrongfully obtain preferential contracting benefits.

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

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

Without an associated and definable loss to the government, criminal prosecutors are often reluctant to pursue action against these companies or, if they do pursue them, may only be

able to obtain limited sentences. For example, in one recent HUBZone case in Kentucky that we were successful in getting a prosecutor to accept, we obtained a guilty verdict, but the sentence was only a \$1,000 fine and two years probation. This light sentence was based upon Federal sentencing guidelines which require that, in determining the extent of loss, a credit must be applied for any benefit (i.e., goods and services) that the Government obtains as a result of the defendant's wrongdoing.

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

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

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

Our efforts to obtain prosecution of preferential contracting fraud have also been complicated by contracting officer error. Too often, good cases are undermined by errors by contracting personnel at Federal agencies who do not comply with small business contracting requirements. We have seen errors where agencies relied on inappropriate governmental databases or company websites to determine whether the firm was eligible for a preferential award or failed to investigate suspicious discrepancies. Too often, however, we find that procurement personnel are unfamiliar with the applicable preferential contracting requirements.

To address this concern, my office, for many years, has identified a management challenge to SBA to work with the Office of Federal Procurement Policy and the various government procurement training organizations to establish robust training of all contractor personnel on preferential procurement regulations and requirements. We are encouraged that the Interagency Task Force on Federal Contracting Opportunities for Small Businesses, which SBA

is co-chairing, has recently issued a report identifying training on small business procurement as one of its key objectives.

Audits of SBA Preferential Contracting Programs

SBA OIG audits over time have identified ongoing problems with SBA's oversight and administration of its preferential contracting programs. In many cases, we have found that SBA is not devoting sufficient resources to perform effective oversight of these programs. (See SBA OIG Audit Reports Nos. 5-18 and 6-15). More effective management and steps to broaden the availability of these programs could reduce barriers to entry.

One current audit that we are close to completing shows that these problems continue. SBA undertakes on-site visits, known as surveillance reviews, to review procuring agency files to determine, among other things, whether contracting offices are properly awarding and monitoring preferential contracts consistent with applicable regulations. Although this report is still in draft, and we are waiting for comments from the Agency, generally speaking, our review found that SBA had only evaluated a limited number of procuring offices over the past seven years, and did not use a systematic, thorough, or consistent approach in identifying which offices were reviewed or which information was evaluated.

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

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

SBA could also take steps to ensure that a broad range of companies benefit from the Agency's preferential contracting programs. In the 1990's, the SBA OIG issued reports raising concerns about the fact that only a small number of 8(a) companies were obtaining a disproportionate number of contracts in the program. As a result, the Agency implemented a cap on the number of sole-source contract awards that 8(a) program participants can obtain.

However, recent SBA OIG audit work found that this problem continues. An OIG review found that the growth in awards to 8(a) firms owned by Alaska Native Corporation (ANC), which are not subject to this sole-source cap, may be restricting opportunities for other

program participants and challenging SBA's oversight capabilities. Long-term 8(a) contracting trends show a continued and significant increase in obligations to ANC-owned participants, many of which were made through sole-source contracts. 8(a) obligations awarded to ANCs grew from \$1.1 billion in FY 2004 (about 13 percent of 8(a) contract dollars) to \$3.9 billion (about 26 percent of total 8(a) dollars) in FY 2008. However, the number of ANC owned firms that earned this 26 percent of 8(a) dollars in FY 2008 represented only 2 percent of companies performing these contracts. This growth suggests that the special advantages afforded ANC-owned firms may be limiting opportunities for other 8(a) participants.

In addition, while the 8(a) program is benefiting Alaska Natives to some extent, the OIG's review showed that a few ANC participants received a disproportionate share of the 8(a) obligations: 50 percent of Federal 8(a) obligations made to ANC participants in FY 2007 went to just 11 (or 6 percent) of the ANC firms reported by SBA to Congress that year. Further, these top 11 ANC-owned firms received 82 percent of their 8(a) obligations through sole source awards. As studies have shown that sole-source contracts do not always provide the Government with the best value, it is questionable whether providing ANCs with contracting advantages under the 8(a) program is the most cost-effective way of assisting Alaska Natives.

Our review also found that many ANC firms have clear advantages over other 8(a) program participants when competing for contracts. Since ANC-owned firms are not subject to all of the size restrictions that apply to other 8(a) participants, the ANC companies often enjoy access to capital, resources, and management expertise not available to other firms in the program. Other recent reports regarding ANC and tribally owned firms have focused on the fact that non-disadvantaged individuals have exerted considerable control over these companies and, in some cases, have improperly benefited by charging exorbitant "management" fees without providing obvious value to the ANC companies.

Conclusion

The SBA OIG will continue to investigate fraud in SBA procurement and other programs and to seek effective solutions to limit waste and inefficiencies and promote the benefits of these programs. Thank you for the opportunity to comment, and I look forward to answering any questions that you may have.