



STATEMENT OF
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BEFORE THE
SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT,
AND REGULATIONS
COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES

OCTOBER 27, 2011

INTRODUCTION

Chairman Coffman and distinguished members of the Subcommittee, thank you for giving the U.S. Small Business Administration (SBA) Office of Inspector General (OIG) an opportunity to discuss misrepresentation and fraud in preferential contracting opportunities for small businesses.

Since its founding in 1953, the SBA has delivered millions of loans, loan guarantees, contracts, counseling sessions, and other forms of assistance to small businesses. Other than disaster assistance, SBA assists small businesses primarily through three programmatic functions: Access to Capital (Business Financing); Entrepreneurial Development (Education, Information, Technical Assistance & Training); and Government Contracting (Federal Procurement).

The SBA OIG was established within SBA by statute to deter and detect waste, fraud, abuse, and inefficiencies in these programs and in SBA operations. Every year, our staff of approximately 110 employees, which includes criminal investigators, auditors, attorneys, and program analysts, conducts criminal investigations, audits, and other reviews resulting in numerous indictments, convictions, and guilty pleas by fraud perpetrators and many recommendations to the agency for improvement or elimination of wasteful or inefficient practices. The SBA OIG's investigations and audits, and recent audits from the Government Accountability Office, have identified systematic challenges in SBA's management of its preferential contracting programs, and fraud and abuse by certain individuals who criminally seek unfair access to government contracting opportunities.

In keeping with the mandate of Section 15(g) of the Small Business Act, SBA's Office of Government Contracting sets goals with other Federal departments and agencies to reach the statutory goal of 23 percent in prime contract dollars to small businesses. This office also provides small businesses with subcontracting procurement opportunities, outreach programs, and training. SBA OIG's investigations and audits have identified systematic challenges in SBA's management of its preferential contracting programs, and fraud and abuse by certain individuals who criminally seek unfair access to government contracting opportunities.

PREFERENTIAL CONTRACTING PROGRAMS

The SBA OIG is very concerned about continued fraud and improper activity in the preferential contracting programs, particularly the Section 8(a) Business Development, Historically Underutilized Business Zones (HUBZone), and Service-Disabled Veteran-Owned (SDVO) programs. While SBA helps eligible socially and economically disadvantaged 8(a) firms compete in the economy through various business development activities, SBA has delegated its 8(a)

contract execution functions to procuring agencies through partnership agreements. These partnership agreements establish the responsibilities between SBA and the procuring agencies for oversight, monitoring, and compliance with procurement laws and regulations governing 8(a) contracts.

Investigations

Most SBA OIG 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. Some significant examples of recent case activity for consideration are below:

- On October 13, 2011, Theodoros Hallas pled guilty to one count of conspiracy to commit wire fraud in connection with his role in a conspiracy with Rajesh Kumar Malik to misrepresent their eligibility to obtain set-aside contracts. The investigations of Malik and Hallas led investigators to uncover the alleged bribery, kickback, and money-laundering scheme that resulted in the October 4, 2011 arrests detailed below.
- Four Virginia men, including two longtime employees of the U.S. Army Corps of Engineers, were arrested on October 4, 2011, on charges stemming from an indictment that accuses them of taking part in a conspiracy involving more than \$20 million in bribes and kickback payments and the planned steering of a \$780 million government contract to a favored contractor.

The indictment details schemes to defraud the government using two major Federal contracts:

The TIGER Contract. The Technology for Infrastructure, Geospatial, and Environmental Requirements (TIGER) contract is a sole source 8(a), Indefinite Delivery/Indefinite Quantity contract. Authorized agencies are able to procure goods or services from this contract without competition by submitting task orders. The current TIGER contract is a five-year contract running from Oct. 1, 2009 through Sept. 30, 2014. Over the term, the total award of orders placed against the TIGER contract is authorized to exceed \$1 billion. EyakTek, an Alaska Native-owned small business based in Dulles, Va., was the prime contractor for the TIGER contract and subcontracted many of the orders from the U.S. Army Corps of Engineers to other businesses.

The CORES Contract. The Contingency Operations Readiness Engineering & Support (CORES) contract is a planned contract that is envisioned as an alternative or potential replacement to the TIGER contract. As planned, the CORES contract would be a five-year contract with an award potential for all contracts placed under it of up to \$780 million. While this contract was planned to be competitive, the indictment alleges that the defendants worked with the chief technology officer and others at “Company A” to devise a scheme to steer the award of the CORES contract to “Company A.” The intent was to use this contract as a way for “Company A” to funnel money and other things of value directly and indirectly to the defendants and others.

- On June 21, 2011, two men were indicted in U.S. District Court for the Middle District of Florida on one count of conspiracy and five counts of wire fraud. The indictment alleges that the subjects devised a scheme whereby they created a company for the purpose of obtaining a \$100 million small business set-aside contract with the Department of Defense (DoD). The subjects used a nominee owner to create the appearance that their company was not affiliated with another firm that they controlled. Their firm had been the incumbent contractor on a previous DoD contract. The subjects allegedly submitted false and misleading information concerning the relationship between the two companies after the affiliation was challenged in the course of a size protest submitted to the SBA Office of Government Contracting. This is a joint investigation with the Defense Criminal Investigative Service.
- On August 18, 2011, the owner of an 8(a) certified business pled guilty in the Eastern District of Virginia to one count of procurement of citizenship or naturalization unlawfully and one count of false statements. His 8(a) certified firm has received over \$3 million in contracts set aside for 8(a) certified businesses. The investigation disclosed he obtained falsified U.S. citizenship documents from a Department of Homeland Security (DHS) employee and used the documents to obtain a DoD security clearance. He also used the same falsified documents as a basis for his claim that he was a U.S. citizen on his firm’s 8(a) application. This is a joint investigation with the DHS-OIG; DHS - Immigration and Customs Enforcement; Department of State - Diplomatic Security Service; and the Department of Labor - OIG.

Despite our success in bringing to justice many 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 sometimes 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 DoD 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.

Other Tools: Suspension and Debarment

As a complement to criminal prosecution and civil fraud recovery, the SBA OIG promotes the use of the Federal suspension and debarment process where

contractors are prohibited from all procurement and other non-entitlement governmental programs for fraudulent and improper conduct. SBA OIG has submitted 84 suspension and debarment referrals to SBA since FY 2009. Of these referrals, 44 were related to contracting and 40 referrals were non-procurement issues. We believe the tools of suspension and debarment are effective enforcement mechanisms that must be proactively pursued against those who wrongfully obtain preferential contracting benefits.

In 2010, the SBA OIG presented the Agency with a plan 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.

Audits

Past SBA OIG audits also have identified 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).

A recent audit of SBA's surveillance review process shows these problems continue. (See SBA OIG Audit Report No. 11-11). 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. 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 8(a) 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 SBA 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.

Other recent audits we completed (Audit 11-14: *SBA's Funding of Information Technology Contracts Awarded to Isika Technologies, Inc.* and Audit 11-08: *SBA's Procurement of Information Technology Hardware and Software through Isika Technologies, Inc.*) found that SBA had awarded a large 8(a) contract to a small business that was actually passing on the bulk of the work on to several non-8(a) companies. This example of a “pass-through” arrangement, where a non-8(a) businesses profit under the guise of a non-8(a) set-aside contract, is detailed below:

During fiscal years (FY) 2009 and 2010, SBA awarded two Indefinite Delivery/Indefinite Quantity (IDIQ) contracts, a Blanket Purchase Agreement (BPA), and six purchase orders for the procurement of information technology (IT) hardware and software. These procurement vehicles totaled nearly \$7.6 million and each was set aside for award to an 8(a) Business Development program participant. The chosen firm, Isika Technologies, Inc (also doing business as iTechnologies) acted as a shell for its non-8(a) subcontractor, which then ordered the products of several large businesses, including Dell, Hewlett Packard, and Ingram-Micro.

Because hardware and software are tangible manufactured items, the procurement was subject to the Nonmanufacturer Rule. (13 CFR 121.406) iTechnologies did not qualify as a manufacturer because they do not produce hardware or software, nor did they add value to the end products required by SBA. iTechnologies also did not qualify as a non-manufacturer because the end products were not those of small businesses, nor did SBA obtain the requisite waiver authorizing the procurement of the end products of large businesses. The acquisition team should have recognized that neither a small business nor an 8(a) set-aside contract should be awarded because the procurement would result in a "pass through" to large businesses.

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.

Related Top Management Challenges

The SBA OIG has identified two Top Management Challenges relating to SBA's preferential contracting programs:

- **Challenge 1. Procurement flaws allow large firms to obtain small business awards and agencies to count contracts performed by large firms towards their small business goals.**

SBA OIG audits and other governmental studies have shown widespread misreporting by procuring agencies since many contract awards that were reported as going to small firms have actually been performed by larger companies. While some contractors may misrepresent or erroneously calculate their size, most of the incorrect reporting results from errors made by government contracting personnel, including misapplication of small business contracting rules. In addition, contracting officers do not always review the on-line certifications that contractors enter into a governmental database prior to awarding contracts. The SBA needs to ensure that contracting personnel are adequately trained on small business procurement and are reviewing this database prior to awarding contracts.

The SBA also needs to address a loophole within General Services Administration Multiple Awards Schedule (MAS) contracts that contain multiple industrial codes. Currently, a company awarded such a contract can identify itself as small on individual task orders awarded under that contract even though it does not meet the size criteria for the applicable task. Thus, agencies may obtain small business credit for using a firm classified as small, when the firm is not small for specific orders under the MAS contract.

- **Challenge 6. The Section 8(a) Business Development (BD) program needs to be modified so more firms receive business development assistance, standards for determining economic disadvantage are justifiable, and SBA ensures that firms follow 8(a) regulations when completing contracts.**

The SBA 8(a) Business Development (BD) program was created to assist eligible small disadvantaged business concerns to compete in the American economy through business development. Previously, the SBA did not place adequate emphasis on business development to enhance the ability of 8(a) firms to compete, and did not adequately ensure that only 8(a) firms with economically disadvantaged owners in need of business development remained in the program. Companies that were "business successes" were allowed to remain in the program and continue to receive 8(a) contracts, causing fewer companies to receive most of the 8(a) contract dollars and many to receive none. The SBA has made some progress in addressing issues, but significant improvements are still needed.

CONCLUSION

Acquisition planning is the most critical part of the acquisition process and establishes the direction for subsequent actions throughout the procurement. According to Federal Acquisition Regulation, the purpose of acquisition planning is to ensure that the government meets its needs in the most effective, economical, and timely manner. SBA OIG investigations and audits evidence support for this principle. In many instances, attempts to defraud the government through false claims or misrepresentations can be identified through due diligence in the acquisition process and post award surveillance by contracting officials.

As noted by the SBA, contracts with the Federal, state, and local governments represent an unparalleled opportunity for small businesses. In fact, the Federal Government is the world's largest purchaser of goods and services. For many small businesses, government contracts provide reliable, sustainable growth. SBA OIG will continue to focus its work to ensure Federal contracts are awarded to small businesses that deserve preferential contracting opportunities. With our interagency partners, SBA OIG will continue to pursue those who defraud the government by lying in order to gain access to Federal set-aside contracts.