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BEFORE THE
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
COMMITTEE ON VETERANS' AFFAIRS AND THE
SUBCOMMITTEE ON CONTRACTING AND WORKFORCE
COMMITTEE ON SMALL BUSINESS
UNITED STATES HOUSE OF REPRESENTATIVES
JOINT HEARING ON
"AN EXAMINATION OF CONTINUED CHALLENGES IN VA'S VETS FIRST VERIFICATION PROCESS"

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Mr. Chairmen and Members of the Subcommittees, thank you for the opportunity to discuss the Office of Inspector General's (OIG) work related to VA's Veteran-Owned and Service-Disabled Veteran-Owned Small Business (VOSB and SDVOSB) programs. 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. My testimony will focus today on the OIG's investigation of allegations that companies and individuals have fraudulently obtained Government noncompetitive set-aside contracts by misrepresenting their status as a VOSB or SDVOSB, which would deprive legitimate, eligible veteran-owned businesses from obtaining contracts earned through their honorable military service. We have also issued two oversight reports in recent years highlighting various problems related to the VOSB and SDVOSB programs. I am accompanied today by Mr. Gregory Gladhill, Audit Manager, Los Angeles Office of Audits and Evaluations.

BACKGROUND

On December 22, 2006, Public Law (P.L.) 109-461, *Veterans Benefits, Health Care, and Information Technology Act of 2006*, established participation goals and other requirements to increase VA contracting opportunities for VOSBs. 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 Verification and Evaluation (CVE) within OSDBU verifies the eligibility of veteran-owned businesses and maintains VetBiz

VIP as required by P.L. 109-461.[1] VA is the only agency within the Federal government that verifies the status of veteran-owned businesses participating in its 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 $3.9 billion in FY 2015, an increase from 15 to 20 percent of VA's total procurement dollars. For FY 2015, the Federal Procurement Data System-Next Generation reported that VA procurements totaled $19.5 billion, of which $3.9 billion went to VOSBs and of that $3.9 billion, $3.5 billion went to SDVOSBs.

The OIG has conducted various reports related to the administration of VA's VOSB and SDVOSB programs, which are listed in Appendix A. We plan to begin our next SDVOSB audit in FY 2017, which will evaluate the effectiveness of OSDBU's verification processes and follow-up on the prior recommendations from our 2011 audit. We have planned this work to allow for the implementation of pending regulatory changes.

FRAUDULENT METHODS USED TO OBTAIN SET-ASIDE CONTRACTS

The continued growth in the VOSB and SDVOSB programs has prompted ongoing concerns that veteran-owned businesses may not be receiving the full benefit of these socio-economic contracting programs. The purpose of the Veterans First Contracting Program is to ensure that legitimately owned and controlled VOSBs and SDVOSBs are able to compete for VA VOSB and SDVOSB set-aside contracts as well as to stimulate the small business community and create economic growth. However, the program's set-aside advantage made it a target of abuse and fraud by ineligible contractors using various deceptive schemes to acquire lucrative VA contracts.

<u>Businesses "Pass Through" Contracts or Do Not Meet Subcontracting Requirements</u>

Federal regulations prescribe thresholds and limitations on subcontracting for VOSB and SDVOSB contracts.[2] For service contracts, the VOSB or SDVOSB generally has requirements to 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. This requirement is generally intended to help ensure the VOSBs and SDVOSBs build their own capabilities and become more competitive and sustain their businesses in a competitive market in the long term. In addition, VOSBs and SDVOSBs are required to submit partnering agreements with their bid proposals so contracting officers can review them prior to award.

Most of our investigations involve "pass-through" schemes where an ineligible business or joint venture/partnership lists veterans or service-disabled veterans as the majority owners of the business, but the nonveteran-owned business either performs or

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[1] Effective September 30, 2013, the former Center for Veterans Enterprise was renamed the Center for Verification and Evaluation. See http://www.va.gov/osdbu/pressreleases/news20131010.asp (Accessed October 31, 2015).

[2] 13 CFR 125.6(b) and 48 CFR 52.219-27(c)

manages the majority of the work and receives the majority of the contracts' funds. The VOSB or SDVOSB wins a contract, performs little to none of the work, and passes through the contract to the ineligible company for a fee or percentage of the award. The VOSB or SDVOSB simply functions as a shell business and "passes through" the work to the ineligible business.

Veterans Do Not Own or Control Businesses

To be eligible for participation in the Veterans First Contracting Program, Federal regulations require 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.[3] 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.

"Rent-A-Vet" schemes occur when an otherwise ineligible business uses a veteran as a front to try to establish VOSB or SDVOSB eligibility. In this scheme, the true owner of a company conspires with a veteran to have the veteran assume ownership of the company in name only. The true owner maintains control over the company, and the veteran receives either a flat fee or a percentage of any contracts awarded and does not perform any functions associated with owning or operating the company. A variation of this scheme involves the establishment of a new firm for the sole purpose of set-aside acquisition. The new firm is not actively managed or controlled by the veteran, who acts only as a figurehead.

Businesses Improperly Use the VOSB or SDVOSB Status Preference

Non-service-disabled or non-veteran schemes also occur when veterans who are not service-disabled or, in some cases, people who are not veterans falsely self-certify their business as an eligible VOSB or SDVOSB. These businesses improperly benefit from the receipt of VOSB and SDVOSB contracts and potentially block eligible VOSBs and SDVOSBs from receiving the contracts for which they are eligible to compete.

Bribery

Bribery schemes occur when a VA employee, typically a contracting officer, contracting officer's representative, or project engineer, conspires with a nonservice-disabled veteran or non-veteran to improperly award a contract in furtherance of one or more of the aforementioned schemes. The VA employee accepts illegal gratuities in exchange for steering contracts to the company.

SUCCESSFUL PROSECUTION OF OIG CASES

Since the inception of the Veterans First Contracting Program, the OIG has been investigating allegations where businesses and individuals have fraudulently obtained Government noncompetitive set-aside contracts by misrepresenting their VOSB or SDVOSB status or eligibility, which would deprive legitimate, eligible veterans from

[3] Title 38, CFR, Part 74.1

obtaining these economic opportunities earned through military service. We have conducted almost 170 investigations involving allegations of VOSB or SDVOSB fraud. Currently, we have about 70 open cases, many of which are being worked jointly with the Small Business Administration (SBA) OIG, the General Services Administration (GSA) OIG, and other Federal law enforcement agencies.

Since FY 2008, our VOSB and SDVOSB investigations have resulted in the indictment of 56 individuals and 5 companies. For those defendants charged, 44 have been convicted to date. Furthermore, courts of jurisdiction have levied approximately $15 million in fines against these defendants and ordered them to pay approximately $6.6 million in restitution. We consider these results a significant achievement because Federal prosecutors were historically reluctant to prosecute what they deemed a "victimless" crime because the Government generally received the goods and services purchased. However, OIG special agents successfully convinced Federal prosecutors that these various schemes victimized legitimate veteran businesses that were not awarded contracts because of corrupt contractors' nefarious activities.

In addition to criminal and civil prosecution, our special agents pursue suspensions and debarments against the individuals and companies involved when there is evidence of cause for such action. The suspension and debarment process protects the Government and taxpayers from fraud, waste, and abuse by using a number of tools to avoid doing business with non-responsible contractors. Since FY 2008, 72 suspension and/or debarment actions have occurred as a result of our investigations.

Following is a discussion of several recent cases in which the prosecutive action is public information. We cannot discuss nonpublic information on pending cases due to the risk of potentially compromising the ongoing criminal prosecutions.

Veterans of the Land (Santa Maria, California)
In May 2015, owners of Veterans of the Land (VOTL) paid $1 million to resolve allegations that it falsely claimed eligibility as an SDVOSB in order to obtain set-aside landscaping and cemetery restoration contracts with VA. From 2008 to 2013, VOTL fraudulently secured approximately $30 million in VA set-aside contracts from the National Cemetery Administration (NCA). The veteran listed as the owner of the SDVOSB admitted that he was not in control of the company. Further investigation revealed that the non-veteran co-owner ran the business, which was similar to his former company that had previously been awarded several NCA contracts prior to 2007—the same year NCA contracts started being designated as SDVOSB set-asides. VOTL has no further contracts with the VA and, as part of the settlement, has agreed to dissolve as a corporation.

Office Dimensions, Inc. (Teaneck, New Jersey)
In May 2014, the president and owner of Office Dimensions, who contracted with VA as an SDVOSB, pled guilty to false claims. A joint investigation by the VA OIG, GSA OIG, and Internal Revenue Service Criminal Investigations revealed that the defendant and her company had been doing business with VA under a GSA Schedule as a Woman-

Owned business since 2008. In 2009, the defendant self-certified her company to be an SDVOSB claiming her father-in-law was the service-disabled owner and operator of the business. In reality, her father-in-law had been denied service connection by VA and never owned or operated the business. During her plea, the defendant admitted that she knew her claims were false and that they led to dozens of contracts to provide furniture and interior space planning at VA facilities. In total, VA paid approximately $1.2 million to Office Dimensions based on contracts set aside for service-disabled veterans. On October 27, 2014, the defendant was sentenced to 2 years of probation including 8 months of home confinement. She was also ordered to pay $100,000 in restitution.

<u>Belkro General Contractors (San Juan, Puerto Rico)</u>
In June 2015, three subjects were indicted and arrested for major fraud against the Government and wire fraud. A VA OIG and SBA OIG investigation revealed that from 2007 to 2014, the defendants used a "pass-through" scheme to create an SDVOSB, Belkro General Contractors, in order to qualify for and obtain VA SDVOSB set-aside construction contracts at the San Juan, PR, VA Medical Center. The defendants created the fraud scheme by using a service-disabled sibling, who was a full-time U.S. Postal Service employee, with no construction experience or equipment to establish a construction business. The veteran was simply a figurehead or "rent-a-vet," who was being used for his service-disabled veteran status to obtain contracts for his brother's company, IRC Air Contractors. As a result of the scheme, Belkro General Contractors unlawfully received approximately $6.6 million in SDVOSB contracts from the VA. In August 2015, all three defendants pled guilty to major fraud against the Government and their sentencings are pending. Belkro General Contractors, IRC Air Contractors, and the three defendants have been suspended from Government contracting pending debarment proceedings

<u>Silver Star Construction (Blue Springs, Missouri)</u>
A joint investigation conducted by the VA OIG, SBA OIG, GSA OIG, and the Defense Criminal Investigative Service determined that Silver Star Construction, LLC (Silver Star) acted as a "pass-through" company for a larger company and that the owner was not a service-disabled veteran. Silver Star received more than $8 million in Government contracts from December 2008 through July 2010. The owner claimed to have been awarded three Silver Stars, four Bronze Stars, three Purple Hearts, and other medals for valor during service in Vietnam, Cambodia, and Laos. In June 2011, the owner, his wife, his son, and the owner of the larger company were indicted for conspiracy, major fraud against the United States, wire fraud, false statements, and engaging in monetary transactions in property derived from specified unlawful activity. The investigation determined that the owner served in the National Guard, was not a service-disabled veteran, and never served overseas. Silver Star had self-certified its SDVOSB status under the earlier regulations.

On April 9, 2012, the owner pled guilty to conspiracy to commit fraud against the United States, major program fraud, wire fraud, money laundering, and making a false statement. In addition, he pled guilty to the forfeiture counts of the indictment which resulted in a $6.8 million judgment against him. He agreed to forfeit personal property, including military medals and medallions, veterans' patches, various certificates and DD 214 forms, and a notebook he labeled "Book of Death" which contained a list of Vietnam War "sniper kills." Further, he was sentenced to 87 months in Federal prison. In October 2015, his wife was sentenced to 20 months in Federal prison after pleading guilty to one count of aiding and abetting wire fraud. His son pled guilty to conspiracy to commit fraud against the United States, major program fraud, and wire fraud and is scheduled for sentencing on November 4, 2015. The owner of the larger company pled guilty to wire fraud in April 2014; sentencing is pending.

<u>Machinga and Coconspirator Companies (Trenton, New Jersey)</u>
In June 2015, a former VA employee who worked as a supervisory engineer at the East Orange, New Jersey, medical campus of the VA New Jersey Health Care System was sentenced to 46 months in prison for accepting more than $1.2 million in kickback payments in connection with VA contracts awarded to companies with which he had relationships, and to engaging in a scheme to defraud the VA by claiming one of those companies was owned by a service-disabled veteran when it was not. As a supervisory engineer, the former employee had the authority and influence to direct certain VA construction contracts to particular companies. He partnered with another individual, who was not a veteran, to set up three companies that could be used to obtain VA work under set-aside SDVOSB contracts. He then directed more than $6 million worth of VA construction projects to those companies. The defendant admitted he accepted $1,277,205 in kickbacks in exchange for his official action and influence between 2007 and July 2012. He also admitted that for many of the projects awarded to the other individual's companies, he recruited other contractors to perform the work so the companies were able to keep the money paid to them without having to incur the expense of actually completing the projects.

<u>Veteran Construction Associates, LLC (Burlington, New Jersey)</u>
In January 2015, Veteran Construction Associates, LLC (Veteran Construction), a construction company headquartered in Burlington, New Jersey, agreed to pay $1.3 million to resolve allegations that it improperly billed VA on Government contracts. Veteran Construction was formed in 2006 and listed a service-disabled veteran as its 51 percent owner. From 2008 through 2011 the company bid on and received SDVOSB set-aside contracts and invoiced the Government for a total of $6.5 million.

However, Veteran Construction was not owned and controlled by a service-disabled veteran, and thus should neither have received the Government contracts nor invoiced the Government for work performed on those contracts. Veteran Construction admitted that it is liable to the United States for its conduct under the False Claims Act. In addition to the $1.3 million payment, the company has agreed that it shall never seek to obtain any Government contracts set aside for veterans of the United States military and will not seek any Government contracts at all for 3 years from the settlement.

M.R. Tafoya Construction, Inc. (Albuquerque, New Mexico)
In June 2014, the owner of M.R. Tafoya Construction, Inc. (Tafoya Construction) and his son-in-law were sentenced for defrauding the SDVOSB program. The owner was sentenced to 57 months in Federal prison to be followed by a year of supervised release, while his son-in-law was sentenced to a 37-month term of imprisonment followed by a year of supervised release. The owner was ordered to pay $1,350,000—the proceeds fraudulently obtained as the result of the criminal activity—with the son-in-law being jointly liable for $500,000 of that amount. The two defendants were charged in February 2012 in an indictment alleging that they obtained almost $11 million in Federal contracts by falsely claiming that the company was qualified to participate in the SDVOSB program. A superseding indictment filed in March 2013 added charges of witness tampering and obstruction of justice against the owner.

The owner admitted that between 2009 and 2010, Tafoya Construction was awarded five contracts valued at an aggregate amount of $10,984,189 that required the company to hold SDVOSB status. During that period, the owner, who is a nonservice-disabled veteran, owned 100 percent of Tafoya Construction stock. He admitted obtaining the lucrative contracts by paying his stepbrother, a service-disabled veteran who works and resides in Florida, a $600 weekly fee to allow Tafoya Construction to use his name and service-disabled status in its bids for SDVOSB contracts. The owner acknowledged asking his son-in-law to complete certifications stating that Tafoya Construction was an SDVOSB and submit them to the VA so that Tafoya Construction could obtain SDVOSB contracts. The owner also admitted that he drew up a number of false documents designed to create the appearance that his stepbrother was the majority owner and controller of Tafoya Construction, when in fact he did not own or operate the company, and that his son-in-law forged the stepbrother's signature on the documents.

The owner lied to an OIG criminal investigator to support the fraudulent claim that Tafoya Construction was an SDVOSB. The owner made the following false statements to the investigator: (1) that the stepbrother paid $100,000 to purchase 51 percent of Tafoya Construction; (2) that the stepbrother worked in Tafoya Construction's Albuquerque office; (3) that the stepbrother was working at a VA construction site in Santa Fe that day; and (4) that the stepbrother personally signed the VA contracts and bonding paperwork on the SDVOSB contracts awarded to Tafoya Construction. The owner also admitted traveling to Florida later in February 2011, to meet with his stepbrother for the purpose of creating fraudulent documents in an attempt to cover up their fraudulent scheme. The owner subsequently submitted these fraudulent documents to a Federal grand jury in July 2011.

In his plea agreement, the son-in-law admitted to participating in the owner's illegal scheme and to filling out and submitting certifications to VA that falsely claimed that Tafoya Construction was owned by a service-disabled veteran. He further admitted signing the stepbrother's signature on bids and other paper work submitted to VA and on documents created to make it appear that the stepbrother was the 51 percent owner of Tafoya Construction. The stepbrother was sentenced on August 26, 2014, to 3 years' supervised release and ordered to pay $66,645 in restitution.

PROPOSED LEGISLATIVE CHANGES

The House Committee on Veterans' Affairs has introduced legislation this session, H.R. 3016, the *Veterans Employment, Education, and Healthcare Improvement Act*, that would require VA to obtain an attestation from program participants, when applying for verification, affirming to the truth of the information submitted in their application and that they have received notice of the consequences of any false statements or information including debarment and civil and criminal penalties. We are optimistic that such a requirement would aid in the deterrence and prosecution of fraudulent activity in this program. We appreciate the opportunity to have collaborated with the Committee on this important piece of legislation and for the showing of support for our mission from Congressman Wenstrup and the many Committee cosponsors on this bill.

CONCLUSION

As our work demonstrates, the OIG has identified a number of weaknesses in the Veterans First Contracting Program, and we have devoted significant resources to investigate individuals and companies who exploit those weaknesses in order to obtain noncompetitive set-aside contracts for Government work. We will continue to pursue these allegations aggressively so that individuals who seek to defraud VA and deprive legitimate service-connected veterans are on notice that justice will be served. However, for its part, VA must continue to take actions to strengthen problem areas in its Veterans First Contracting Program and pursue solutions that ensure legitimate veteran-owned businesses are receiving the contracts intended for them. Contracting processes must also be strengthened to ensure participation requirements are effectively met after contracts are awarded in order to protect the socio-economic interests related to these set-aside advantages. We will begin our next SDVOSB audit in FY 2017 to evaluate the effectiveness of OSDBU's verification processes and follow-up on the prior recommendations from our 2011 audit, and we would be happy to brief members of the Committee on the results of our work.

Mr. Chairmen, this concludes my statement. We would be pleased to answer any questions that you or other members of the Subcommittees may have.

APPENDIX A

VA Office of Inspector General
Reporting on the Veteran-Owned and Service-Disabled Veteran-Owned Small Business Programs

August 20, 2012	*Review of Enterprise Technology Solutions, LLC Compliance with Service-Disabled Veteran-Owned Small Business Program Subcontracting Limitations* http://www.va.gov/oig/pubs/VAOIG-12-01235-132.pdf
April 12, 2012	*Administrative Investigation, Improper Contracts, Conflict of Interest, Failure to Follow Policy, and Lack of Candor, Health Administration Center, Denver, Colorado* http://www.va.gov/oig/pubs/VAOIG-10-02328-154.pdf
July 25, 2011	*Audit of the Veteran-Owned and Service-Disabled Veteran-Owned Small Business Programs* http://www.va.gov/oig/52/reports/2011/VAOIG-10-02436-234.pdf
July 14, 2010	*Review of Allegations of Improper Contract Awards to Watkins Sinclair, LLC* http://www.va.gov/oig/52/reports/2010/VAOIG-09-02322-192.pdf