

Contracting program to help the disadvantaged riddled with fraud

By Robert Brodsky rbrodsky@govexec.com April 30, 2010

It's happened again. For the third time in as many years, a watchdog found that con artists and ineligible companies gamed the government's procurement system to fraudulently win small business contracts, this time in a program designed to assist economically disadvantaged individuals.

In a [report released on Friday](#) to the House Small Business Committee, the Government Accountability Office identified 14 firms that received set-aside or sole-source 8(a) contracts worth a combined \$325 million through fraud or abuse. All together, these firms won an additional \$1.2 billion in contracts since entering the 8(a) program, including \$17 million in Recovery Act awards.

"The 8(a) program needs to strengthen its fraud prevention, detection, monitoring and investigative controls to minimize its vulnerability to fraud and abuse," the report said.

Investigators found companies representing themselves as disadvantaged despite owning yachts, luxury automobiles and millions of dollars in ocean-front property. The maximum threshold for entering the 8(a) Business Development Program is \$250,000 in annual net worth, excluding the applicant's ownership interest of the company and primary residence. Other executives misrepresented their ethnicity or used a pass-through company to continue winning contracts long after graduating from the program, GAO found.

Fraud in the Small Business Administration's contracting programs is nothing new. In 2008, GAO created [bogus companies](#) to win small business contracts in the Historically Underutilized Business Zone program. Last November, the watchdog reported on [extensive fraud](#) in the veteran-owned service-disabled small business contracting program.

"Fraud has been a persistent problem with all of the SBA's contracting programs and it is clear from this report, as well as previous work done by the committee and GAO, that SBA needs to do a better job of ensuring

these initiatives work as intended," said Rep. Nydia Velazquez, D-N.Y., chairwoman of the House Small Business Committee, in a statement to *Government Executive*.

To participate in the 8(a) program, an applicant must be considered a small business, be unconditionally owned and controlled by a socially or economically disadvantaged individual, show the potential for success and be of "good character." Companies must graduate from the program within nine years.

But GAO found the program is easy to manipulate. For example, a Toms River, N.J., construction company owner reported his adjusted net worth to be \$217,000 when it was actually more than \$800,000, according to the watchdog. Nonetheless, the firm won \$11.2 million in 8(a) contracts from the Defense and Homeland Security departments. The company withdrew from the 8(a) program in September 2009 as a result of GAO's investigation.

In another case, investigators found that a roofing and construction company in Hyattsville, Md., with \$48.3 million in contracts was acting as a pass-through for a graduated firm. Both firms were actually run by a white father-and-son team; the 8(a) program is designed for minority-owned firms. The two businesses essentially were operating as one company, the report said, sharing top executives, staff, administrative offices and warehouse space.

The fraud became apparent to investigators during a visit to the business. "The white vice president disclosed much of the operational knowledge of the firm during the site visit, while the black president rarely spoke," GAO said. "The white executives both work out of large suites while the black president sits in a small room located at the back of the building."

The report identified several other instances in which companies established shell companies that would win the award, but not perform any of the work. Some executives hid their lavish lifestyle from SBA, including the president of an information technology firm in Bethesda, Md., who owns a \$2.5 million house on a private island in Miami, a \$450,000 yacht and a \$200,000 Lamborghini, investigators found.

GAO brought three cases to SBA, but the agency failed to take action, allowing the companies to continue winning contracts. For instance, an IT firm in Fairfax, Va., should have been removed from the program after its president failed to disclose \$4.2 million in personal property, the report found.

"We brought the unreported assets to the attention of SBA," the report said. "However, once SBA learned that the firm was scheduled to graduate in eight months, it no longer wanted to investigate the firm's actions. Eleven days later, the firm was awarded a \$1.7 million contract."

Even firms that voluntarily disclosed ineligibility remained in the program. The president of a human resources firm in Alexandria, Va., told SBA she had an annual salary of nearly \$750,000-- well above the threshold to remain in the program -- yet officials allowed the company to stay in the program for another five years.

In response to the findings, SBA conceded that its fraud prevention systems needed improvement. "Although the 8(a) business development program has enjoyed numerous successes, we recognize that there are weaknesses and areas that require increased monitoring and oversight," wrote Joseph Jordan, associate administrator for government contracting and business development.

The agency did have a measure of success in screening out bogus applications GAO submitted. In three cases, SBA discovered questionable assets and income with the fake companies. But in another instance, investigators obtained 8(a) certification for a phony firm using fabricated documents.

"Certification of GAO's bogus firm shows vulnerabilities in the process such as the lack of any face-to-face contact that could allow ineligible individuals or pass-through companies to enter the program," the report said.

According to SBA, in fiscal 2008, there were 9,462 firms certified to participate in the 8(a) program, and about half had at least one active sole-source or set-aside contract. Agencies [awarded more than \\$16 billion](#) in 8(a) contracts that year, allowing the government to exceed its

goal of giving 5 percent of all contracts to small disadvantaged businesses.

In October, SBA [recommended major changes](#) to the eligibility and income requirements of the 8(a) program. The rule is expected to be finalized by June.

SBA spokesman Michael Stamler said Friday that the proposed regulatory changes would address "several of the recommendations made by the GAO, and will strengthen the program and maximize its benefits for eligible small businesses." He added SBA is "taking further steps, in line with GAO recommendations, to prevent fraud, waste and abuse."