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HOUSE COMMITTEE ON SMALL BUSINESS
SUBCOMMITTEE ON CONTRACTING AND THE WORKFORCE and
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Chairman Hanna, Chairman Coffman, Ranking Member Meng, Ranking Member Kirkpatrick, and Members of the Subcommittees, thank you for inviting me to testify on statutory, regulatory and interpretive differences between the Small Business Administration (SBA) and Department of Veterans Affairs (VA) contracting programs for small businesses owned and controlled by service-disabled Veterans.

Overview

Since its inception, the VA Verification program has faced challenges balancing the need to prevent ineligible firms from taking improper advantage of VA's "Veterans First" program, while making it easier and faster for legitimate Veteran-owned small businesses (VOSB) and service-disabled Veteran-owned small businesses (SDVOSB) to gain greater access to VA procurement opportunities. VA has made substantial progress on both fronts in our effort to implement 38 Code of Federal Regulations (CFR) Part 74, the regulation governing verification. As we improved the verification process we realized that most of the remaining issues were associated with the rule itself. To better understand the regulatory issues, VA reached out to stakeholders and as a result of their feedback, VA has initiated a formal rule change process in accordance with the Regulatory Flexibility Act and Executive Order 13272 (Proper Consideration of Small Entities in Agency Rulemaking).

In the aftermath of both VA's Office of the Inspector General (OIG) report dated July 25, 2011, and the Government Accountability Office (GAO) report dated October 26, 2011, our imperative was to ensure all firms listed as eligible in the VA program had been properly verified as meeting the standards laid out in 38 CFR Part 74. Both VA OIG and GAO made recommendations for improvement. We have addressed all of the recommendations identified in the 2011 reports. In its latest report, GAO-13-95 Planning and Data System for VA's Verification Program Need Improvement, January 14, 2013, GAO acknowledges improvement by stating: "Since December 2011, VA has instituted a number of significant operational changes, including revising standard operating procedures and enhancing quality assurance protocols." Based on the report recommendations, VA made changes to its verification processes and policies. These changes include increased fraud awareness training for all VA Center for Veterans Enterprise (CVE) staff as well as support contractors, the development of better

education tools to help applicants through our Verification Assistance Program, and reduction of fraud risk through a post-verification audit process.

CVE initiated the post-verification audit process to ensure that verified companies continued to be in compliance with program eligibility rules throughout the tenure of their two-year verification term. This process chooses firms based on both random and risk basis. This process was launched in May 2012; CVE has performed 158 random audits and 112 risk-based audits in the fiscal year 2013 to date, resulting in ten cancellations.

Comparison of Rules Governing Verification Program

We believe the most significant difference between VA and SBA's programs lies in the volume of status determinations made by each program. By statute, a VOSB and an SDVOSB must provide documentation to VA to demonstrate its status and VA must verify this information before the firm can do business with VA as an SDVOSB. As SBA notes, this process is inherently more labor-intensive than a protest-based self-certification program. This statutory requirement resulted in VA making more than 4,500 status determinations in FY 2012 alone. Because SBA only determines SDVOSB status and only when a protest is filed, the SBA made only 40 status determinations over the past two fiscal years.

Despite this statutorily-driven difference in the way the programs are run, there has existed in the stakeholder community a widespread concern that there are major differences between the VA and SBA regulations, even though the regulation that governs VA's Verification program, 38 CFR Part 74, was derived in large part from the ownership and control portions of the SBA regulations that cover the Government-wide SDVOSB program in 13 CFR Part 125, as well as the regulation that covers the section 8(a) business development program, 13 CFR Part 124,. In response to that concern, VA, in collaboration with SBA, conducted a thorough comparison of the ownership and control portions of the regulations. In addition to comparing regulatory language, we also looked at every SDVOSB status protest considered by SBA and all of the SBA Office of Hearings and Appeals decisions on SDVOSB cases for the last two fiscal years to identify any differences in interpretation.

While we are in the process of discussing our findings with SBA, our tentative conclusion is that there are only a few differences in the regulation and interpretation of them and we are fully committed to working with SBA and conducting stakeholder outreach to help address these differences.

There are two statutory differences between the programs due to the provisions of Public Law (P.L.) 109-461, as codified in 38 United States Code (U.S.C.) Sections 8127 and 8128. The two statutory differences are:

1. Application to Veteran-Owned Small Businesses: Section 8127(f) states: "Database of Veteran-Owned Businesses. - (1) Subject to paragraphs (2) through (6), the Secretary shall maintain a database of small business concerns owned and controlled by veterans and the veteran owners of such

business concerns." VA's authority includes both SDVOSBs and VOSBs; whereas the government-wide SBA program only addresses SDVOSBs.

2. Surviving Spouse: Section 8127(h): "Treatment of Businesses After Death of Veteran-Owner. - (1) Subject to paragraph (3), if the death of a veteran causes a small business concern to be less than 51 percent owned by one or more veterans, the surviving spouse of such veteran who acquires ownership rights in such small business concern shall, for the period described in paragraph (2), be treated as if the surviving spouse were that veteran for the purpose of maintaining the status of the small business concern as a small business concern owned and controlled by veterans." This currently applies to Veterans that were 100 percent service-disabled or who died as a result of a service-connected disability. SBA's program has no surviving spouse exception.

Since there were only two major statutory differences, VA derived its regulation mainly from 13 CFR Part 125, which implements the government-wide SDVOSB set-aside program established by 15 U.S.C. 657f, and 13 CFR Part 124.105 and 124.106. Where 13 CFR Part 125 was silent, VA considered language from 13 CFR Part 124. In addition, in our examination of SBA status protest decisions and SBA Office of Hearings and Appeals (OHA) decisions, as well as discussions directly with representatives from SBA, we found that in most cases where SBA's SDVOSB regulation is silent, SBA applies the provisions of the 8(a) regulation. For example, in its decision SBA No. VET-102 (2005), SBA OHA's decision states: "OHA has recognized that the regulations regarding control of 8(a) Business Development and Small Disadvantaged Business program participants can provide guidance in interpreting the control requirement of SDVO SBC eligibility."

Our comparison of the regulations revealed three differences between VA's Verification regulation and SBA's SDVOSB regulation.

1. VA added a requirement for a VOSB to notify the CVE of a change of ownership in 38 CFR 74.3(e). Although this requirement is noted in 13 CFR 124.105(i), this requirement is moot in the SBA SDVOSB regulation due to the self-certification nature of the program.
2. VA added a provision when the final rule was published, based on public comments, which is specific to Employee Stock Ownership Plans (ESOP) that does not appear in either the SDVOSB or the 8(a) regulations. VA included a provision that would consider certain ESOP's to meet the requirements of direct ownership by the Veteran(s).

Differences in Interpretation

Once we determined what actual language differences existed between the regulations, we looked for differences in the interpretation of the rules. We compared VA's interpretations to the SBA status protests and OHA decisions rendered over the last two fiscal years to see where any differences occurred. While VA is not bound by

the SBA decisions, due to the similarities of the SDVOSB programs, VA finds the SBA case law can be persuasive authority. We could find only two clear cases where the VA interpretation differed from the SBA interpretation.

In both 38 CFR 74.4(f) and 13 CFR 125.10(e)(1), the regulations state "[n]o single veteran owns 51 percent of all voting stock but multiple veterans in combination do own at least 51 percent of all voting stock, each such veteran is on the board of directors, no supermajority voting requirements exist, and the veteran shareholders can demonstrate that they have made enforceable arrangements to permit one of them to vote the stock of all as a block without a shareholder meeting. Where the concern has supermajority voting requirements, the Veteran shareholders must own at least that percentage of voting stock needed to overcome any such supermajority ownership requirements."

If we look at a sample situation where two Veterans own at least 51 percent of the voting stock of a company and a non-Veteran also owns voting stock, VA interprets this language that a non-Veteran has the power to control the decision of the board of directors if the Veteran shareholders split their vote and the non-Veteran casts the deciding vote. The SBA interpretation of this situation is that the non-Veteran must vote with a Veteran to win the decision. VA is prepared to alter its interpretation to align with SBA in this case.

Although VA seeks to align its interpretations with SBA, based on stakeholder discussions and feedback, we have determined that transfer restrictions that are part of normal commercial dealings, such as the right of first refusal, do not materially affect the ability of a Veteran to unconditionally own or control the business. Therefore, effective March 6, 2013, VA will no longer interpret the current regulation to mean that such restrictions constitute a reason for denying eligibility.

Potential Rule Change

VA has initiated stakeholder outreach as part of a process to identify potential changes to the rules based on the lessons learned from the implementation of the current verification regulation. We have reached out informally to a broad range of stakeholders as part of this process, and received a number of recommendations worthy of consideration. As part of this process we expect to publish an Advanced Notice of Proposed Rule Making in the Federal Register that will provide all stakeholders a formal method of providing feedback and input that will be used to draft proposed rule changes governing VA VOSB Verification.

Given the current alignment with the SBA's programs, any consideration of changes to VA verification rules will involve discussion with the SBA as we seek to keep the two programs aligned.

Process

In view of the long history of small business certification programs in the SBA, VA also reviewed the processes and metrics used in the SBA 8(a) certification program to determine lessons learned and best practices that we could apply to the VA verification program. As a result of this review, we have adopted two practices:

1. We noted that when SBA contacts an applicant, it uses emails followed up by a phone call to confirm receipt of the communication. CVE has added a phone call to confirm that an applicant received email communications where any type of documentation is requested, or if a firm receiving a Preliminary Findings letter has not responded to CVE within 48 hours.
2. We also noted that SBA followed a practice of contacting an applicant with preliminary findings where there are issues of non-compliance that can easily and quickly be corrected and allowing them to correct those issues prior to a determination. Through an analysis of the most frequent reasons for which firms are being denied, CVE identified a set of issues that will not require a full re-evaluation and can be quickly corrected. These issues occur in more than 50 percent of our current denials. Applicants that could be denied for these issues will be provided a Preliminary Findings letter extending the opportunity to make corrections or withdraw, prior to a determination. For more complicated issues that would require a full re-evaluation, firms will be notified and will have the option to withdraw their application and re-submit without receiving a determination.

We are currently running a series of limited pilots to validate this proposed process and train CVE staff on procedures for engagement with applicants. The program is targeted for a full launch on May 1, 2013.

Program Improvements

One of the major findings of the recent GAO report was that the Management Information System that supports verification is woefully inadequate for our purposes. VA agrees that our current information system is the biggest obstacle to meeting our verification objectives, and we have taken steps to fix it. The next generation Verification Case Management System (VCMS) is currently under development, and we expect to award a contract for a new system in May 2013. This will be a phased program with initial operational capability expected in October 2013.

While we have been aggressively pursuing the development of a new system, we discovered that SBA is also developing a new system for their 8(a) program. We have reached out to SBA to compare technical requirements. We are currently determining if the new SBA system, which is further along in its development, could be applied to both programs.

GAO acknowledged that VA has made improvements to the program, and as a result of a number of process improvements, we have reduced the average time to initial determination from more than 130 days during the summer of 2011 to an average

of 46 days for those applications completed last month. We still have a challenge in reducing the time for achieving final determinations in response to requests for reconsideration, a process that offers a "second chance" to firms found to be non-compliant. The process of reaching a final determination took an average of 128 days for firms receiving decisions in February 2013. While we are working to reduce the time required, we recognize that the best method to do so is to reduce the number of applications that are declared ineligible. Our analysis of initial denials revealed that most denials occur because the applicant does not understand the regulation or how it applies to their business model.

As a result, our efforts to reduce the time and difficulty of achieving eligibility have focused on educating applicants regarding the application of the regulation and helping them understand what their business model needs to be to fit the requirements of the program. Our Verification Assistance Program currently consists of three elements:

1. An online self assessment tool that takes a Veteran through each section of the regulation and all the required documents and explains how they relate to the regulation.
2. A series of 17 Verification Assistance Briefs that explain the requirements and give examples of why firms are denied. These briefs address issues that cause more than 70 percent of all denials.
3. Realizing some applicants need extra assistance, we established a counseling program in partnership with non-profit organizations to provide counseling services to Veterans preparing to apply for verification. The program was piloted in June 2012, and we continue to develop and improve it. All counselors now receive the exact same qualification training that our examiners, evaluators, and site visitors receive. To ensure transparency and consistency in interpretation, we have integrated our counselors into the same qualification training and testing that our examiners, evaluators and site visitors receive.

In addition to the current program elements we will launch a fourth dimension to the program with the pilot of our first Pre-Application workshop for Veterans on March 13, 2013, at an event hosted by the SDVOSB Council in Virginia. This workshop will outline what a Veteran needs to know and do to put together a successful verification application.

Conclusion

In conclusion, VA has made significant progress in its VOSB verification program. We have overcome many of the challenges and vulnerabilities that were raised by the GAO and OIG reports but we seek continuous improvement, and in coordination with SBA, we seek to revise our regulation to achieve balanced objectives.

Mr. Chairmen and Members of the Subcommittees, this concludes my statement. I am pleased to answer any questions you may have.