



U.S. Small Business Administration

OFFICE OF
INSPECTOR GENERAL

OCT 2 2000

Honorable Elaine Kaplan
Special Counsel
U.S. Office of Special Counsel
1730 M Street NW, Suite 300
Washington, DC 20036-4505

Re: OSC File No. DI-00-0147
SBA/OIG File: 07-1099-12

Dear Ms. Kaplan:

In response to your November 12, 1999, letter to Aida Alvarez, Administrator, U.S. Small Business Administration, Ms. Alvarez delegated her authority to me to investigate Jose Gutierrez' allegations and report the results to your office. We have now completed our investigation and related audit work.

Enclosed for your review is a summary of the allegations, OIG findings, and the Agency's comments and proposed actions. We are also providing our Report of Investigation and four final audit reports. Finally, we are enclosing SBA's full response detailing its comments and proposed actions. SBA's response indicates that it will not be taking any disciplinary action against any employee.

If you or your staff have any questions, do not hesitate to contact me at (202) 205-6586 or Richard R. Smith, Assistant Inspector General for Investigations, at (202) 205-6220.

Sincerely,

Phyllis K. Fong
Inspector General

Enclosures

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A

List of Allegations, Findings, and Agency Comments and Actions

I. Violation of Law in the Solicitation of a Grant Recipient

A. Allegations: It was alleged that Dr. Richard Hayes, then Associate Deputy Administrator for Government Contracting & Minority Enterprise Development (GC&MED), SBA, solicited the University of North Carolina (UNC) to apply for a Section 7(j) grant in an attempt to curry favor for himself. It was also alleged that AmeriCorps/Vista might have received a Section 7(j) grant they were not entitled to receive.

- **Findings:** The allegations were not substantiated. UNC officials stated they had developed a proposal with AmeriCorps/Vista after downloading the 7(j) information off SBA's web site. They met with Dr. Hayes and other SBA officials and submitted their proposal to SBA. According to Dr. Hayes, that meeting was arranged by Charles Payne, then Chief of Staff, Minority Enterprise Development (MED), and Jose Gutierrez.

UNC officials stated that they never discussed employment opportunities with Dr. Hayes prior to his resignation from SBA. After he resigned, UNC officials called Dr. Hayes and suggested that he apply for a position at UNC. They mailed him an application package, but he never replied. Dr. Hayes advised that he met with UNC officials on only one occasion and did not discuss employment opportunities. Dr. Hayes stated he received the application package after he resigned from SBA, but he did not apply because he did not want to leave the Washington, DC, area.

Regarding the second allegation, SBA's Office of General Counsel issued an opinion that AmeriCorps/Vista can legally receive a Section 7(j) grant. (Report of Investigation (ROI), page 2)

- **Agency Comments and Action Taken/Proposed:** This allegation was not substantiated. No action warranted.

II. Violation of Conflict of Interest Laws in Selection of Contractor

A. Allegation: It was alleged that Dr. Hayes selected Boscart Construction, Inc. (Boscart), through the Section 8(a) contract assistance program without utilizing any competitive bidding process.

- **Findings:** The allegation that Dr. Hayes selected Boscart for the contract was not substantiated. The allegation that the contract was not competitively bid was substantiated; however, under SBA regulations, the Agency has the authority to select any 8(a) contractor without using the competitive bidding process if the contract is a Section 8(a) contract and under \$3 million. The Boscart contracts related to the 8th floor build-out met those criteria. (ROI, page 4)

The OIG audit of SBA's contracts with Boscart, however, disclosed noncompliance with certain provision of the Section 8(a) program and Standards of Conduct regulations in the award of the Boscart contracts. For example, SBA's Washington District Office did not ensure that Boscart had submitted required financial statements prior to award of the contracts in accordance with 13 CFR 124.503. As Boscart had not submitted the required statements, the company was not eligible for the contract award. SBA also awarded the contract without first obtaining required Standards of Conduct Committee approval. Approval was required under 13 CFR 105.302 because Boscart's owner was a member of the National Small Business Development Center Advisory Board. (Audit Report on Boscart Construction, Inc., pages 6-9)

- **Agency Comments:** The Agency does not agree that Boscart was ineligible for the 8(a) contracts it received, nor that SBA's Standards of Conduct regulations were violated except in a procedural sense. It is very possible that the contracts would have been found by the Standards of Conduct Committee not to cause an appearance of conflict of interest.
- **Agency Action Taken/Proposed:** The Agency will review the relationship between noncompliance with technical aspects of 8(a) program participation and contract award opportunities, and then issue clarifying procedures. The Agency will establish procedures to better ensure sharing of information among agency officials that may trigger the need for a Standards of Conduct Committee review.

B. Allegation: It was alleged that Dr. Hayes selected Boscart to benefit his friend, Oscar Turner, a former SBA employee, in violation of conflict of interest laws.

- **Findings:** This allegation was not substantiated. The OIG investigation revealed that Boscart was selected for the 8th floor build-out by Thomas Dumaresq, Assistant Administrator, Office of Administration. Mr. Dumaresq and other SBA officials interviewed stated that Mr. Dumaresq, not Dr. Hayes, had selected Boscart for the contract. Further, Mr. Dumaresq and others advised that neither Dr. Hayes, nor any member of his staff, made any recommendation concerning the selection of Boscart. (ROI, page 4)

Finally, no evidence was developed during the course of the OIG investigation that established that Dr. Hayes and Mr. Turner were anything other than professional associates. (ROI, page 4)

- **Agency Comments and Action Taken/Proposed:** This allegation was not substantiated. No action warranted.

C. Allegation: It was alleged that Dr. Hayes and Mr. Turner colluded to enhance the value of the 8th floor build-out, making the award more lucrative to Mr. Turner's wife, Barbara, the President of Boscart; that Boscart falsified cost data and substituted inferior products; and that Boscart defaulted on the contract forcing a new contractor to complete the job.

- **Findings:** The allegation of collusion was not substantiated. Although the contract to Boscart was expanded to include the construction of a local area network room, the investigation revealed no evidence to establish that Dr. Hayes colluded with Mr. Turner to enhance the value of the 8th floor contract. (ROI, page 5)

The allegation that Boscart falsified cost data was not substantiated. No information was disclosed during the OIG audit which indicated that Boscart provided false cost data to SBA. (ROI, page 5)

The allegation that Boscart substituted inferior products was not substantiated. During an OIG interview, Mr. Gutierrez clarified his allegation that Boscart substituted inferior products during the build-out of the 8th floor. Mr. Gutierrez advised that what he meant to convey was that Boscart's workmanship was unsatisfactory and that a number of items had to be replaced or repaired. According to the OIG audit these items were identified on a "punch list." The audit did not disclose the use of any inferior products. (ROI, page 5)

The allegation that Boscart defaulted on the contract was not substantiated; however, the OIG audit determined that the Agency directed Boscart to cease work, citing the company's failure to complete a "punch-list," which detailed work that remained to be performed. SBA incurred additional costs of at least \$15,000 to complete the "punch list." Further, the Agency settled a request for payment of \$322,000 by Boscart for cost overruns, modifications, etc., by making a \$70,000 increase to one of the contracts without adequate documentation to justify that action. (Audit Report on Boscart Construction, Inc., pages 12-15)

- **Agency Comments:** The Agency does not agree with an inference that Boscart provided unsatisfactory performance. While the Agency did increase the contract value by \$70,000 in settlement of a much larger request for payment of \$322,000 on this and a related contract, Boscart performed work that actually exceeded the modified value of the contract. The SBA received full value for the money spent.
- **Agency Action Taken/Proposed:** The Agency intends to document its files more fully on these matters.

D. Allegation: It was alleged that Dr. Hayes pressured Mr. Gutierrez and Calvin Jenkins, SBA Associate Administrator, One Stop Capital Shop, to award the 8th floor build-out contract to Boscart.

- **Findings:** This allegation was not substantiated. Mr. Gutierrez alleged that Dr. Hayes pressured him and Mr. Jenkins to award the 8th floor build-out contract to Boscart. Mr. Jenkins did not corroborate this allegation. Mr. Jenkins stated the allegation was completely false and that the selection of Boscart was made by Mr. Dumaresq. (ROI, page 6)

Mr. Dumaresq and others further advised that neither Dr. Hayes nor any member of his staff made any recommendation concerning the selection of Boscart. (ROI, page 4)

- **Agency Comments and Action Taken/Proposed:** This allegation was not substantiated. No action warranted.

E. Allegation: It was alleged that Title 13, *U.S. Code of Federal Regulations*, Part 105, sections 202 and 203, and Title 5, *U.S. Code of Federal Regulations* (CFR), section 2635.101, were violated when Dr. Hayes solicited a contract for Boscart.

- **Findings:** The alleged violation of 13 CFR 105.202 was not substantiated. 13 CFR 105.202 relates to the employment of a former SBA employee by a person who was previously a recipient of SBA assistance. This section does not apply because Mr. Turner did not work for SBA prior to his employment at Boscart and Boscart did not hire him after he left SBA.

The alleged violation of 13 CFR 105.203 was not substantiated. 13 CFR 105.203 states that no assistance will be given to any person who has an employee who, within 1 year prior to the assistance, was an SBA employee. Again, this section does not apply to the Boscart contract because Mr. Turner did not work for SBA prior to his employment at Boscart and Boscart did not rehire him after he left SBA.

The alleged violation of 5 CFR 2635.101 was not substantiated. The Agency's selection of Boscart for the 8th floor build-out contract, however, initially may have suggested an appearance of preferential treatment because Boscart's owner was the wife of an SBA employee. 5 CFR 2635.101(8) states that "employees shall act impartially and not give preferential treatment to any private organization or individual." 5 CFR 2635.101(14) states that "employees shall endeavor to avoid any actions creating the appearance that they are violating the law or the ethical standards set forth in this part. Whether particular circumstances create an appearance that the law or regulations have been violated shall be determined from the perspective of a reasonable person with knowledge of the relevant facts."

The Agency contracting official requested an ethics opinion from the Designated Agency Ethics Officer (DAEO) prior to awarding the contracts. The DAEO rendered an opinion, based in part on erroneous information, and advised that there was no appearance of a conflict of interest.

SBA has a specific regulation addressing assistance to its employees or members of the employee's household at 13 CFR § 105.204, which provides that "without the prior written approval of the Standards of Conduct Committee, no SBA assistance, other than Disaster loans . . . shall be furnished to a person when the sole proprietor, partner, officer, director or significant stockholder of the person is an SBA employee or a household member." The DAEO concluded that Oscar Turner was not an owner, officer, or director of Boscart and, based on his separation from Barbara Turner, the owner of Boscart, they were not members of the same household. Thus, no approval was required by the Standards of Conduct Committee. When apprised that a sizable contract had, in fact, been awarded after the date of Mr. Turner's SBA employment, the DAEO advised that "given [the employee's] employment at the time in the Office of Capital Access, his non-involvement with his wife's firm, and separation from her, and separate residence, it is unlikely that I would have advised SBA contracting officials that I saw an ethics problem in awarding 8(a) contracts to Boscart."

The OIG audit of Boscart, however, determined that SBA did not comply with 13 CFR 105.302 because it did not obtain the prior approval of its Standards of Conduct Committee in awarding Boscart contracts while the company's owner was a member of the National Small Business Development Center Advisory Board. (Audit Report of Boscart Construction, Inc., pages 8-11)

- **Agency Comments:** The Agency agrees that a referral was not made to SBA's Standards of Conduct Committee regarding the owner's service on an advisory committee.
- **Agency Action Taken/Proposed:** As indicated above, the Agency will develop improved information sharing on this point.

III. Violation of Conflict of Interest and SBA Regulations in Solicitation of Employment and Billing Irregularities Regarding the MBELDEF Co-sponsorship Agreement

A. Allegation: It was alleged that Dr. Hayes directed Anthony Robinson, President, MBELDEF, to hire Mr. Turner.

- **Findings:** The specific allegation that Dr. Hayes directed Mr. Robinson to hire Mr. Turner could not be substantiated, because the information developed was conflicting and inconsistent. Given the totality of the circumstances, however, it appears Dr. Hayes violated 5 CFR 2635.101(8) when he recommended that MBELDEF hire Mr. Turner to work on the co-sponsorship agreement. This action had a direct effect on MBELDEF and resulted in a financial gain for Mr. Turner.

5 CFR 2635.101(8) states that employees shall act impartially and not give preferential treatment to any private organization or individual. 5 CFR 2635.101(14)

states that employees shall endeavor to avoid any actions creating the appearance that they are violating the law or the ethical standards set forth in the conflict of interest regulations. It further states, "whether particular circumstances create an appearance that the law or these standards have been violated shall be determined from the perspective of a reasonable person with knowledge of the relevant facts."

- **Agency Comments:** The Agency believes it is not clear whether Dr. Hayes violated ethics regulations. Employees are permitted to comment favorably on the qualifications of other employees or former employees seeking employment.
- **Agency Action Taken/Proposed:** The Agency intends to take no action on this matter unless a referral is made to the Designated Agency Ethics Official (DAEO) for a determination as to whether an ethics violation occurred. Even if the DAEO concludes a violation occurred, SBA can take no action because Dr. Hayes is no longer employed by SBA.

B. Allegation: It was alleged that 13 CFR 105.202 and 105.203 were violated when Dr. Hayes recommended that Mr. Robinson hire Mr. Turner.

- **Findings:** The allegation that Mr. Hayes violated 13 CFR 105.202 and 105.203 was not substantiated.

13 CFR 105.202 relates to the employment of a former SBA employee by a person who was previously a recipient of SBA assistance and states that no former employee, who occupied a position of discretion with respect to granting or administering the assistance, may occupy a position with that concern. This section does not apply because the co-sponsorship agreement was signed before MBELDEF hired Mr. Turner. Mr. Turner was an SBA employee at the time the co-sponsorship agreement was signed, but had no discretion over the agreement or its administration.

13 CFR 105.203 states that no assistance will be given to any person who has an employee who, within 1 year prior to the assistance, was an SBA employee. This section also does not apply because, by definition, a co-sponsorship is not officially considered "assistance." (ROI, page 8)

- **Agency Comments and Action Taken/Proposed:** The allegation was not substantiated. No action warranted.

C. Allegation: It was alleged that Charles Payne created false documentation that facilitated the payment of over \$300,000 in unsubstantiated billings under the MBELDEF co-sponsorship agreement.

- **Findings:** During an OIG interview, Mr. Gutierrez stated that he was not alleging that Mr. Payne had created false documentation. He clarified his earlier allegation

and stated instead that Mr. Payne had prepared a memorandum that facilitated the payment of the MBELDEF expenditures and that the memorandum could not be supported. The allegation was partially substantiated.

According to Mr. Payne and Susan Sundberg, Attorney, OGC, payment to MBELDEF occurred only after they had obtained invoices and/or cancelled checks to support each expenditure. After examining the invoices with OGC, Mr. Payne prepared a memorandum to support the payment of the invoices they had deemed to be appropriate. (ROI, page 9)

An audit of MBELDEF revealed that some of the costs included in Mr. Payne's memorandum did not have the required supporting invoices. Of the approximately \$728,000 of approved expenditures, SBA did not receive invoices for almost \$133,000, or 18 percent of the total. One such expense was for over \$77,000.

It was also disclosed during the investigation and audit that SBA officials exempted MBELDEF from submitting invoices that were individually under \$1,000. These invoices under \$1,000 totaled over \$31,000. (Audit of SBA's Administration of the MBELDEF Co-sponsorship, page 15; ROI, page 9)

- **Agency Comments:** The Agency does not agree with any inference that improper conduct was engaged in by any SBA official. The decision to exempt submission of invoices below \$1,000 was a consensus decision made by several agency employees, was well-intentioned, and was made for practical reasons. The Agency has no doubts that any missing larger invoices occurred because of inadvertence. The Agency also understands that some of the paid expenses represent added salary costs incurred by MBELDEF for work on the Co-sponsorship, for which a typical "invoice" from a third party would not be available
- **Agency Action Taken/Proposed:** The Agency will look into the OIG's finding that some larger invoices were apparently not received. Additionally, the Agency will press MBELDEF for a final accounting if one has not yet been received. In future cases where a co-sponsorship involves an expenditure of federal funds, the Agency will utilize the services of employees experienced in reviewing and tracking expenditures to better control and account for funds. The Agency also will not exempt small value invoices absent a written procedure cleared by the OIG.

D. Allegation: It was alleged that Dr. Hayes abused his authority by improperly influencing the selection of MBELDEF to coordinate a 12-city tour that promoted the Small Disadvantaged Business (SDB) program.

- **Findings:** The allegation that Dr. Hayes abused his authority by improperly influencing the selection of MBELDEF was not substantiated. Dr. Hayes had the authority to select MBELDEF and OGC approved the co-sponsorship agreement on September 24, 1998. Dr. Hayes, however, abused his authority when he ignored the

continuing and compounding problems with the co-sponsorship agreement and prohibited his staff from taking any corrective action. (ROI, page 9)

- **Agency Comments:** The Agency was not able to conclude that an abuse of authority occurred without further inquiry. If an abuse of authority did occur, the Agency can no longer take any action against Dr. Hayes since he is no longer employed by SBA.
- **Agency Action Taken/Proposed:** The Agency intends to reinforce the SOP provisions invoking the Agency's oversight committee when problems in administration arise. This role of the oversight committee is not widely known, but the Agency will correct that. The Agency also will make it clear that concerned employees may communicate directly with the committee.

IV. Violation of Law Governing the Use of Appropriated Funds

- A. **Allegation:** It was alleged that funds appropriated for the Small Disadvantaged Business (SDB) program were used for non-SDB purposes.
 - **Findings:** The allegation was substantiated. The OIG audit on SDB obligations and expenditures found that about \$3.0 million of the \$13.6 million sampled expenditures and obligations were related to non-SDB certification activities. These unallocable activities included construction and furnishings, equipment, personnel costs, consulting costs, training, and marketing. In addition, SBA cancelled its plans to obligate approximately \$410,000 for a construction project after our auditors questioned the appropriateness of using SDB funds for the project. An additional \$3.2 million for SDB overhead expenditures and development costs for an electronic application system lacked sufficient supporting documentation to enable the auditors to conclude whether the costs were correctly allocated. After the end of audit fieldwork, SBA completed a cost allocation study, which justified \$2.8 million (which is included in the \$3.2 million lacking sufficient supporting documentation) that was allocated to overhead. (Audit of SDB Certification Program Obligations and Expenditures, pages i, 8, 9 and 13)
 - **Agency Comments:** This comment applies to Findings IV.A., IV.B., IV.C., and IV.E. In management's response to this audit finding, SBA agreed to reimburse the SDB certification program about \$2.3 million with SBA-appropriated funds for non-SDB certification related activities. SBA also agreed to deobligate \$.6 million from SDB obligations. In each case of misallocation described in these Findings, SBA used funds available for support of the 8(a) program since 8(a) firms are also SDB firms. Not only did SBA make the reimbursements agreed to, but SBA also has appointed new managers to administer its government contracting and minority enterprise development programs generally, reorganized that Office for tighter accountability, and instituted approved accounting controls.
 - **Agency Action Taken/Proposed:** Described above.

B. Allegation: It was alleged that Dr. Hayes awarded a contract to Research Planning Inc. (RPI), to establish a business assessment tool for the benefit of the Section 8(a) program and a second contract to upgrade the executive information system for the SBA Minority Enterprise Development program. Mr. Gutierrez alleged that, although these contracts were funded with SDB monies, they had no connection with and did not benefit the SDB program.

- **Findings:** The allegation was substantiated in that SDB funds were used for these non-SDB purposes. RPI's \$649,839 contract to establish a business assessment tool for the benefit of the Section 8(a) program and SETA's \$133,810 contract to upgrade the executive information system for the SBA MED program were both unrelated to the SDB program. (Audit of SDB Certification Program Obligations and Expenditures, pages 5 and 13)
- **Agency Comments:** See IV. A. above.
- **Agency Action Taken/Proposed:** Described above.

C. Allegation: It was alleged that Dr. Hayes authorized expenditures from SDB funds for non-SDB training conferences.

- **Findings:** The allegation was substantiated. SBA held two training conferences that covered four SBA programs: Government Contracting, Section 8(a), SDB, and HUBZone Empowerment Contracting. SBA charged the entire expense for these two conferences to the SDB program. Of the \$46,763 obligated for training at the Crystal City Hilton, \$35,072 was not allocable to the SDB program. Of the \$619,785 obligated for training at the Lansdowne Resort, \$460,511 was not allocable to the SDB program. (Audit of SDB Certification Program Obligations and Expenditures, pages 5 and 13)
- **Agency Comments:** See IV. A. above.
- **Agency Action Taken/Proposed:** Described above.

D. Allegation: It was alleged that Dr. Hayes awarded two contracts to the African American Small Business Exporters Association (AASBEA), using SDB funds. According to Mr. Gutierrez, these contracts had nothing to do with the SDB program.

- **Findings:** This allegation was not substantiated. During an OIG interview, Mr. Gutierrez clarified his earlier allegation and advised that Dr. Hayes directed RPI, an SBA contractor, to subcontract work to AASBEA. Mr. Gutierrez stated that Gwendolyn Flowers, a former SBA employee, would be able to confirm his allegation. When interviewed, Ms. Flowers did not corroborate Mr. Gutierrez'

allegation. Ms. Flowers explained that William Fisher, Mr. Gutierrez' predecessor, made her aware of AASBEA. Ms. Flowers further explained that she did not want to contact RPI directly because she did not want RPI to feel pressured to use AASBEA. Ms. Flowers stated that, instead, she contacted Sharon Gurley, Director, Office of Procurement and Grants Management. Ms. Flowers told Ms. Gurley that AASBEA had in-house expertise that may be of value to RPI. Ms. Flowers then stated that Ms. Gurley contacted RPI and passed on the information. Ms. Gurley confirmed Ms. Flowers' explanation. (ROI, Page 11)

- **Agency Comments and Action Taken/Proposed:** The allegation was not substantiated. No action warranted.

E. Allegation: It was alleged that Dr. Hayes misdirected funds into the Section 8(a) program.

- **Findings:** This allegation was substantiated in that SDB funds were used for non-SDB expenses, including Section 8(a) expenses. These non-SDB expenses were for equipment, personnel, consulting, training, and marketing. Dr. Hayes authorized the requisitions for some of these items. The audit did not accumulate the total cost of misdirected funds into the Section 8(a) program, but rather, accumulated the total amount that was used for non-SDB certification purposes. (Audit of SDB Certification Program Obligations and Expenditures, pages 4, 5 and 13)
- **Agency Comments:** See IV. A. above.
- **Agency Action Taken/Proposed:** Described above.

B



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

OFFICE OF THE ADMINISTRATOR

DATE: October 2, 2000
TO: Phyllis K. Fong
Inspector General
FROM: Aida Alvarez
Administrator *Aida Alvarez*
SUBJECT: Office of Special Counsel Referral

I am responding to your memorandum of September 21, 2000, in which you ask for my comments and proposed actions relative to your investigation.

You asked for my response by September 27, 2000, and my staff gave you a draft on that date.

The period of time given us to comment on this referral, as well as on three related draft audit reports, was extremely short. [Separate responses will address the related draft audit reports].

We are willing to continue to work with you and your staff if needed. My comments on the Office of Special Counsel Referral investigation are set out below, and follow your outline numbering.

II.A. Comment:

We do not agree that the Boscart was ineligible for the 8(a) contracts it received, nor that our Standard of Conduct regulations were violated except in a procedural sense. It is very possible that the contracts would have been found by the Standards of Conduct Committee not to cause an appearance of conflict of interest.

Proposed Action

We will review the relationship between noncompliance with technical aspects of 8(a) program participation and contract award opportunities, and to then issue clarifying procedures. We also will establish procedures to better ensure sharing



of information among agency officials that may trigger the need for Standards of Conduct Committee review.

II.C. Comment

We do not agree with an inference that Boscart provided unsatisfactory performance. While we did increase the contract value by \$70,000 in settlement of a much larger request for payment of \$322,000 on this and a related contract, Boscart performed work that actually exceeded the modified value of the contract. The SBA received full value for the money spent.

Proposed Action

We intend to document our files more fully on these matters.

II.E Comment

We agree that a referral was not made to our Standards of Conduct Committee regarding the owner's service on an advisory committee.

Proposed Action

As indicated above, we will develop improved information sharing on this point.

III.A. Comment

We believe it is not clear whether Dr. Hayes violated ethics regulations. Employees are permitted to comment favorably on the qualifications of other employees or former employees seeking employment.

Proposed Action

We intend to take no action on this matter unless a referral is made to the Designated Agency Ethics Official (DAEO) for a determination as to whether an ethics violation occurred. Even if the DAEO concludes a violation occurred, SBA can take no action because Dr. Hayes is no longer employed by SBA.

III.C. Comment

We do not agree with any inference that improper conduct was engaged in by any SBA official. The decision to exempt submission of invoices below \$1,000 was a consensus decision made by several agency employees, was well-intentioned, and was made for practical reasons. We have no doubt that any missing larger

IV.B. Comment

See IV.A. above.

Action Taken

Described above.

IV.C. Comment

See IV.A. above.

Action Taken

Described above.

IV.E. Comment

See IV.A. above.

Action Taken

Described above.

invoices occurred because of inadvertence. We also understand that some of the paid expenses represent added salary costs incurred by MBELDEF for work on the Cosponsorship, for which a typical "invoice" from a third party would not be available.

Proposed Action

We will look into your finding that some larger invoices were apparently not received. Additionally, we will press MBELDEF for a final accounting if one has not yet been received. In future cases where a cosponsorship involves an expenditure of federal funds, we will utilize the services of employees experienced in reviewing and tracking expenditures to better control and account for funds. We also will not exempt small value invoices absent a written procedure cleared by your office.

III.D. Comment

We are not able to conclude an abuse of authority occurred without further inquiry. If an abuse of authority did occur, we can no longer take action against Dr. Hayes since he is no longer employed by SBA.

Proposed Action

We intend to reinforce the SOP provisions invoking the agency's oversight committee when problems in administration arise. This role of the oversight committee is not widely known, but we will correct that. We also will make it clear that concerned employees may communicate directly with the committee.

IV.A. Comment

This comment applies to Findings IV.A., IV.B., IV.C., and IV.E. In management's response to this audit Finding, SBA agreed to reimburse the SDB certification program about \$2.3 million with SBA appropriated funds for non-SDB certification related activities. SBA also agreed to deobligate \$.6 million from SDB obligations. In each case of misallocation described in these Findings, SBA used funds available for support of the 8(a) program since 8(a) firms are also SDB firms. Not only did we make the reimbursements agreed to, but we also have appointed new managers to administer our government contracting and minority enterprise development programs generally, reorganized that Office for tighter accountability, and instituted approved accounting controls.

Action Taken

Described above.

C

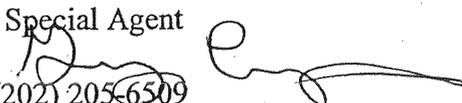
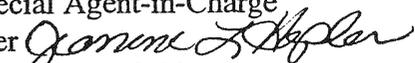
U.S. SMALL BUSINESS ADMINISTRATION
Office of Inspector General
Investigations Division

Title Richard L. Hayes Former Associate Deputy Administrator Government Contracting & Minority Enterprise Development U.S. Small Business Administration	Case # 07-1099-12
	Period of Investigation 10/25/99 – 9/18/00
	Date of Report 9/29/00

SUMMARY

This case was initiated based on allegations of fraud, waste, and abuse received in a letter, dated October 19, 1999, sent to Phyllis K. Fong, Inspector General, U.S. Small Business Administration (SBA), from Sheldon I. Cohen, attorney for Jose Gutierrez, Deputy District Director, Washington District Office, SBA. Gutierrez' allegations were also reported in a letter dated November 12, 1999, from the U.S. Office of Special Counsel (OSC) to SBA Administrator Aida Alvarez. The OCS reported that there was a "substantial likelihood that violations of law, rule or regulation, a gross waste of funds, and an abuse of authority have occurred at the SBA."

The Office of Inspector General (OIG), Investigations Division, investigated the allegations purported by Gutierrez and our findings are detailed below. Various matters were referred to the OIG's Auditing Division. Their findings are enumerated in four audit reports. The OIG also referred any potential criminal violations to the U.S. Attorney's Office for the District of Columbia for prosecutive consideration. Prosecution was declined and these matters were referred back to the Agency for appropriate action.

Report made by Special Agent Gerry Crispino  Telephone No. (202) 205-6509	Distribution: IG AIGI AIGA SBA Administrator OSC
Approval by Special Agent-in-Charge Jeanine L. Hepler  Telephone No. (202) 205-6393	

DETAILS OF THE INVESTIGATION

This case was initiated based on allegations of fraud, waste, and abuse received in a letter, dated October 19, 1999, sent to Phyllis K. Fong, Inspector General, U.S. Small Business Administration (SBA), from Sheldon I. Cohen, attorney for Jose Gutierrez, Deputy District Director, Washington District Office, SBA. Gutierrez' allegations were also reported in a letter dated November 12, 1999, from the U.S. Office of Special Counsel (OSC) to SBA Administrator Aida Alvarez. The OSC reported that there was a "substantial likelihood that violations of law, rule or regulation, a gross waste of funds, and an abuse of authority have occurred at the SBA."

In general terms, Gutierrez alleged that his former supervisor, Dr. Richard L. Hayes, then Associate Deputy Administrator for Government Contracting & Minority Enterprise Development (GC&MED), SBA, misappropriated funds, and used appropriated funds for purposes other than those for which the funds were designated. Gutierrez also alleged that Hayes engaged in conflicts of interest by attempting to secure funding through SBA grant programs for entities and institutions in which he was personally interested and by securing contracts and employment for a friend.

I. Violation of Law in the Solicitation of a Grant Recipient

A. Allegation: It was alleged that Dr. Richard Hayes, then Associate Deputy Administrator, Government Contracting and Minority Enterprise Development (GC&MED), SBA, solicited the University of North Carolina (UNC) to apply for a 7(j) grant in an attempt to curry favor for himself. It was also alleged that AmeriCorps/Vista might have received a 7(j) grant they were not entitled to receive.

Findings: The allegations were not substantiated. Charles Payne, then Chief of Staff, Minority Enterprise Development (MED), SBA, stated that Dr. James Johnson, UNC, The Kenan Center, Chapel Hill, NC, contacted him and requested a meeting between SBA and UNC officials. The purpose of the meeting was for UNC officials to explain what type of work was being conducted at UNC and for UNC to learn SBA's 8(a) program needs. Payne stated that he agreed to a meeting and facilitated the arrangements.

In May 1999, UNC officials met with SBA officials at SBA Headquarters. The meeting was attended by Hayes; Payne; Jose Gutierrez, then Associate Administrator, MED; Johnson; and other officials from UNC. When interviewed about the meeting, Hayes stated that Johnson explained what type of research UNC was performing in collaboration with the Kenan-Flager Business School, and how he thought UNC could assist SBA's 8(a) program. Hayes also stated that at the conclusion of the presentation, it was understood that UNC would work out the final details of their proposal with Payne and Gutierrez and then formally present their plan to SBA. Hayes charged Payne with heading the UNC project. Gutierrez assisted Payne with the project details. UNC later submitted a 7(j) grant

proposal to SBA. Hayes' explained that his involvement with UNC was limited to his participation in the initial meeting and stated that he had no further involvement with UNC until he received their formal proposal.

During an interview with Payne, he explained that UNC officials had learned about some of the issues confronting the Agency from AmeriCorps/Vista and SBA's website. That information served as the impetus for UNC's proposal to SBA. Investigative interviews corroborated Payne's explanation. Hayes was also questioned about the allegation that he, or members of his staff, solicited UNC to apply for a 7(j) grant. Hayes adamantly stated that the first time he met or had been in contact with anyone from UNC was when UNC officials conducted their presentation before his staff in May 1999. Hayes stated that SBA was initially approached by UNC concerning a 7(j) proposal, not vice versa.

On June 29, 1999, Hayes received UNC's 7(j) proposal from Payne who recommended approval. Hayes concurred with Payne's position and recommended approval of the proposal to the Administrator. Hayes stated Payne and Gutierrez were initially supportive of the UNC proposal. By the end of the fiscal year, however, Gutierrez no longer favored the 7(j) grant to UNC and tried to present new ideas and proposals of his own. Hayes opined that since Gutierrez' ideas and proposals came too late in the fiscal year and were rejected, Gutierrez became disenchanted with UNC's proposal.

During an interview with UNC officials, Johnson stated that he never discussed employment opportunities with Hayes prior to Hayes' resignation. After Hayes resigned from SBA, Johnson called Hayes and suggested that he apply for a position at UNC. Johnson mailed Hayes an application package, but he never replied. Hayes too was questioned concerning the allegation that he was currying favor with UNC for future employment consideration. Hayes explained that after he resigned from SBA he received a telephone call from Johnson. Johnson asked him if he would be interested in working for UNC. Hayes stated to Johnson that he did not know what he was going to do for employment. Johnson mailed Hayes an employment application, but Hayes decided that he did not want to relocate to North Carolina. Hayes never completed the application mailed to him, made any attempt to secure a position with UNC, or had any further contact with Johnson.

Regarding the second issue involving AmeriCorps/Vista, SBA's Office of General Counsel (OGC) issued an opinion that AmeriCorps/Vista could legally receive a 7(j) grant.

II. Violation of Conflict of Interest Laws in Selection of Contractor

A. Allegation: It was alleged that Dr. Hayes selected Boscart Construction, Inc. (Boscart), through the Section 8(a) contract assistance program without utilizing any competitive bidding process.

Findings: The allegation was not substantiated. SBA regulations permit the Agency to select any 8(a) contractor without using the competitive bidding process if the contract is an 8(a) contract and under \$3 million. The Boscart contracts related to the 8th floor build-out met those criteria. However, an audit of SBA's contracts with Boscart disclosed noncompliance with certain provisions of the Section 8(a) program and Standards of Conduct regulations in the award of the Boscart contracts. For example, SBA's Washington District Office did not ensure that Boscart had submitted the required financial statements prior to award of the contracts in accordance with 13 CFR 124.503. As Boscart had not submitted the required statements, the company was not eligible for the contracts award. SBA also awarded the contract without first obtaining required Standards of Conduct Committee approval. Approval was required under 13 CFR 105.302 because Boscart's owner was a member of the National Small Business Development Center Advisory Board. (Audit Report on Boscart Construction, Inc.)

According to Thomas Dumaresq, Assistant Administrator, Office of Administration (OA), he selected Boscart for the contracts based on information he had obtained earlier on the company. Dumaresq first became aware of Boscart 2 years before the SDB program began. Betsy Myers, a former SBA employee, brought Boscart to his attention. Myers informed Dumaresq that she knew Barbara Turner and that Turner was the owner of an 8(a) company. At that time, OA was looking for new contractors to work with SBA. Dumaresq called Turner and arranged a meeting. Following their meeting, SBA began using Boscart on small projects. In Dumaresq's opinion, Boscart was a good 8(a) company and that was why he selected it for the 8th floor build-out. Dumaresq made it clear that neither Hayes, nor any member of his staff, recommended Boscart or exerted any influence in his decision to use Boscart.

B. Allegation: It was alleged that Dr. Hayes selected Boscart to benefit his friend, Oscar Turner, a former SBA employee, in violation of conflict of interest laws.

Findings: The allegation was not substantiated. Hayes was not involved in the selection of Boscart for the contract to build out the 8th floor. Furthermore, no evidence was developed during the course of the investigation that established Hayes and Turner were anything other than professional associates. Hayes and Turner were interviewed concerning the nature of their relationship. Each characterized their relationship as professional in nature. SBA employees familiar with Hayes and Turner were also interviewed. Those interviews also

disclosed that the relationship between Hayes and Turner was professional and not personal.

Sharon Colbert, Staff Assistant, OA, worked for Calvin Jenkins, Associate Administrator, One Stop Capitol Shop, when he served as Hayes' Deputy. Colbert worked for Jenkins and Hayes simultaneously during the period of January to August 1998. When asked to comment on the relationship between Hayes and Turner, Colbert stated that Turner came by unannounced about once a day to see Hayes and that his visits appeared to be business in nature. She categorized their relationship as professional, not personal.

In August 1998, Hayes hired Nancy Singer, Public Affairs Specialist, as his staff assistant. Singer was responsible for maintaining Hayes' daily schedule from August 1998 to September 1999. She was located just outside Hayes' office during that period. Most people who wanted an appointment with Hayes arranged it through her. Singer stated that, in her opinion, Hayes and Turner were not friends. Singer thought that Hayes considered Turner an annoyance, because he kept disrupting Hayes during the workday. Hayes was very selective with whom he met and Turner was bumped off Hayes' schedule a few times. Singer was asked to evaluate the suggestion that Turner met with Hayes two or three times a day. She advised that a statement of that nature would be false.

C. Allegation: It was alleged that Hayes and Oscar Turner colluded to enhance the value of the 8th floor build-out, making the award more lucrative to Turner's wife, Barbara, the President of Boscart. It was also alleged that Boscart falsified cost data, substituted inferior products, and defaulted on the contract forcing a new contractor to complete the job.

Findings: The allegations of collusion and product substitution were not substantiated. Although the contract to Boscart was expanded to include the construction of a local area network room, no evidence was established that indicated collusion between Hayes and Turner. Dumaresq; Jenkins; and Sharon Gurley, Director, Office of Procurement and Grants Management, OA, were interviewed concerning the 8th floor build-out. Those interviews disclosed that Hayes was not involved with the contract negotiations or the statement of work for the 8th floor build-out.

The allegation that Boscart falsified cost data was not substantiated. No information was disclosed during the OIG audit which indicated that Boscart provided false cost data to SBA.

The allegation that Boscart substituted inferior products was not substantiated. During an OIG interview, Mr. Gutierrez clarified his allegation that Boscart substituted inferior products during the build-out of the 8th floor. Mr. Gutierrez advised that what he meant to convey was that Boscart's workmanship was unsatisfactory and that a number of items had to be replaced or repaired.

According to the OIG audit these items were identified on a "punch list." The audit did not disclose the use of any inferior products. (ROI, page 5)

The OIG audit determined that it was not clear from the files that the contract requirements were completed. The Agency did, however, direct Boscart to cease work, citing the company's failure to complete a "punch-list," which detailed work that remained to be performed. Further, the Agency settled a request for payment of \$322,000 by Boscart for cost overruns, modifications, etc., by making a \$70,000 increase to one of the contracts without adequate documentation to justify its decisions. (Audit Report on Boscart Construction, Inc.)

D. Allegation: It was alleged that Hayes pressured Gutierrez and Jenkins to award the 8th floor build-out contract to Boscart.

Findings: This allegation was not substantiated. Gutierrez alleged that Hayes pressured him and Jenkins to award to award the 8th floor build-out contract to Boscart. Jenkins did not corroborate this allegation. Jenkins stated the allegation was completely false and that Dumaresq selected Boscart for the contract. As stated earlier, Dumaresq made it clear that neither Hayes, nor any member of his staff, recommended Boscart or exerted any influence in his decision to use Boscart.

E. Allegation: It was alleged that Title 13, *U.S. Code of Federal Regulations*, Part 105, sections 202 and 203, and Title 5, *U.S. Code of Federal Regulations* (CFR), section 2635.101, were violated when Hayes solicited a contract for Boscart.

Findings: The allegation relating to 13 CFR 105.202 was not substantiated. This section relates to the employment of a former SBA employee by a person who was previously a recipient of SBA assistance. This section does not apply because Turner did not work for SBA prior to his employment at Boscart and Boscart did not hire him after he left SBA.

The allegation relating to 13 CFR 105.203 was not substantiated. This section states that no assistance will be given to any person who has an employee who, within 1 year prior to the assistance, was an SBA employee. Again, this section does not apply to the Boscart contract because Turner did not work for SBA prior to his employment at Boscart and Boscart did not rehire him after he left SBA employee.

The alleged violation of 5 CFR 2635.101 was not substantiated. The Agency's selection of Boscart for the 8th floor build-out contract, however, initially may have suggested an appearance of preferential treatment because Boscart's owner was the wife of an SBA employee. 5 CFR 2635.101(8) states that "employees shall act impartially and not give preferential treatment to any private organization or individual." 5 CFR 2635.101(14) states that "employees shall endeavor to avoid any actions creating the appearance that they are violating the

law or the ethical standards set forth in this part. Whether particular circumstances create an appearance that the law or regulations have been violated shall be determined from the perspective of a reasonable person with knowledge of the relevant facts.”

The Agency contracting official requested an ethics opinion from the Designated Agency Ethics Officer (DAEO) prior to awarding the contracts. The DAEO rendered an opinion, based in part on erroneous information, and advised that there was no appearance of a conflict of interest.

SBA has a specific regulation addressing assistance to its employees or members of the employee’s household at 13 CFR § 105.204, which provides that “without the prior written approval of the Standards of Conduct Committee, no SBA assistance, other than Disaster loans . . . shall be furnished to a person when the sole proprietor, partner, officer, director or significant stockholder of the person is an SBA employee or a household member.” The DAEO concluded that Oscar Turner was not an owner, officer, or director of Boscart and, based on his separation from Barbara Turner, the owner of Boscart, they were not members of the same household. Thus, no approval was required by the Standards of Conduct Committee. When apprised that a sizable contract had, in fact, been awarded after the date of Turner’s SBA employment, the DAEO advised that “given [the employee’s] employment at the time in the Office of Capital Access, his non-involvement with his wife’s firm, and separation from her, and separate residence, it is unlikely that I would have advised SBA contracting officials that I saw an ethics problem in awarding 8(a) contracts to Boscart.”

III. Violation of Conflict of Interest and SBA Regulations in Solicitation of Employment and Billing Irregularities Regarding the Minority Business Enterprise & Legal Defense Fund, Inc. (MBELDEF), Co-Sponsorship Agreement

A. Allegation: It was alleged that Hayes directed Anthony Robinson, President, MBELDEF, to hire Oscar Turner.

Findings: The allegation that Hayes specifically directed Robinson to hire Turner was not substantiated; however, given the totality of the circumstances, it appears Dr. Hayes violated 5 CFR 2635.101(8).

During an interview with OIG, Hayes was asked to explain the circumstances surrounding Robinson hiring Turner. Hayes explained that one day Robinson came to his office for a visit. While they were visiting, Turner came by, and Hayes introduced him to Robinson. Hayes recalled stating to Robinson, “Here is someone you may want to take a look at to help you.”

In a letter to SBA dated March 26, 1999, Robinson referred to Turner when he stated that MBELDEF was “...saddled with an incompetent project manager, a

former SBA employee, that the SBA insisted should handle the job. Despite being told that the SBA would feel more comfortable that MBELDEF could handle the contract with this person as the project manager, the project manager has alienated district offices, mistreated venue employees, and has poisoned the good will of my organization. Even though the damage has been done, the project manager has been terminated.”

Although, in his letter, Robinson stated that SBA insisted he hire Turner, when interviewed by the OIG, he recanted and stated that Hayes had only recommended he hire Turner to work at MBELDEF. Robinson explained that he met with Hayes to discuss the problems and concerns he had with the co-sponsorship agreement. He asked Hayes for his advice and assistance in resolving the problems with SBA. Hayes advised Robinson that Turner was leaving SBA and said that he (Turner) could resolve the issues with SBA and provide conference planning expertise. During a subsequent OIG interview, Robinson stated that although Hayes did not force him to hire Turner, a recommendation from someone like Hayes was not simply dismissed.

5 CFR 2635.101(8) states that employees shall act impartially and not give preferential treatment to any private organization or individual. 5 CFR 2635.101(14) states that employees shall endeavor to avoid any actions creating the appearance that they are violating the law or the ethical standards set forth in the conflict of interest regulations. It further states, “whether particular circumstances create an appearance that the law or these standards have been violated shall be determined from the perspective of a reasonable person with knowledge of the relevant facts.” Given the totality of the circumstances, it appears Dr. Hayes violated 5 CFR 2635.101(8) when he recommended that MBELDEF hire Mr. Turner to work on the co-sponsorship agreement. This action had a direct affect on MBELDEF and resulted in a financial gain for Mr. Turner.

B. Allegation: It was also alleged that 13 CFR 105.202 and 203 and 5 CFR 2635.101 were violated when Hayes recommended that Robinson hire Oscar Turner.

Findings: The allegation that Hayes violated 13 CFR 105.202 was not substantiated. This section relates to the employment of a former SBA employee by a person who was previously a recipient of SBA assistance and states that no former employee who occupied a position of discretion with respect to granting or administering the assistance may occupy a position with that concern. This section does not apply because the co-sponsorship agreement was signed before MBELDEF hired Turner. Turner was an SBA employee at the time the co-sponsorship agreement was signed, but had no discretion over the agreement or its administration.

The allegation that Hayes violated 13 CFR 105.203 was not substantiated. This section states that no assistance will be given to any person who has an employee

who, within 1 year prior to the assistance, was an SBA employee. This section also does not apply because, by definition, a co-sponsorship is not officially considered "assistance."

C. Allegation: It was alleged that Payne, created false documentation that facilitated the payment of over \$300,000 in unsubstantiated billings under the MBELDEF co-sponsorship agreement.

Findings: During an OIG interview, Gutierrez stated that he was not alleging that Payne had created false documentation. He clarified his earlier allegation and stated instead that Payne had prepared a memorandum that facilitated the payment of the MBELDEF expenditures and that the memorandum could not be supported. This allegation was substantiated. SBA officials exempted MBELDEF from submitting all invoices that were individually under \$1,000, and in one instance, SBA paid MBELDEF for an expense for over \$77,000 without any supporting invoice.

Susan Sundberg, Attorney, OGC, was questioned concerning any billing irregularities relating to the co-sponsorship agreement. Sundberg advised that she and Payne had examined all the invoices provided by MBELDEF. She explained that only those invoices deemed appropriate were paid.

Payne was interviewed concerning the payments made to MBELDEF. Payne also reported that he and Sundberg examined all the invoices provided by MBELDEF and that only those invoices that were deemed appropriate were paid. Once a review of all the invoices was completed, Payne prepared a memorandum that authorized a final payment to MBELDEF. The memorandum was approved by OGC, and SBA paid MBELDEF the monies due them. Payne added that there were countless invoices for under \$1,000. It was agreed by a committee examining MBELDEF's expenditures, that MBELDEF would not be required to provide invoices for expenditures under \$1,000.

To ensure an accurate accounting of all the expenditures made under the co-sponsorship agreement, an OIG audit was conducted. The audit supported Gutierrez' allegations. (Audit of SBA's Administration of the MBELDEF Co-Sponsorship and Audit of Minority Business Enterprise Legal Defense and Education Fund, Inc., Cosponsorship Expenses and Income)

D. Allegation: Gutierrez alleged that Hayes abused his authority by improperly influencing the selection of MBELDEF to coordinate a 12-city tour that promoted the Small Disadvantaged Business (SDB) program.

Findings: The allegation that Hayes abused his authority by improperly influencing the selection of MBELDEF was not substantiated. Hayes had the authority to select MBELDEF and OGC approved the co-sponsorship agreement on September 24, 1998. Hayes, however, abused his authority when he ignored

the continuing and compounding problems with the co-sponsorship agreement and prohibited his staff from taking any corrective action.

Problems with the co-sponsorship agreement began to occur even before it was signed. In early September 1998, Terri A. Dickerson, Acting Associate Administrator, Office of SDB Certification and Eligibility, SBA, met with Robinson and John Turner, MBELDEF. During that meeting, she explained in detail that MBELDEF's proposal needed to address the scope of services they would provide under the co-sponsorship agreement. A few days later, Dickerson received MBELDEF's proposal, which was unacceptable and did not meet SBA's guidelines. At that point, she questioned MBELDEF's capabilities. Coming from a non-profit organization herself, she knew there were numerous non-profit firms that could have provided a more responsive proposal and deliver the desired services. Dickerson voiced her concerns to Hayes. He ignored her concerns and responded by directing Dickerson to get the co-sponsorship agreement signed.

In a letter dated September 30, 1998, MBELDEF's President wrote that MBELDEF did not have adequate resources to provide the amount of personal services required as the in-kind contribution in the co-sponsorship agreement without a severe impact MBELDEF. According to Robinson, Hayes told him that they would worry about that later. Hayes, however, never took any corrective action to address this problem. Dickerson was also aware of the in-kind contribution problem, but she was told by Hayes, "Don't worry about it."

Once the training was underway, Dickerson explained that she and SBA received a massive number of complaints from vendors and SBA officials concerning MBELDEF's performance. Dickerson advised that she attempted to resolve these complaints by dealing directly with Robinson. Robinson responded by sending letters to Capitol Hill and contacting the White House to complain about Dickerson. In January 1999, Hayes called Dickerson to his office to discuss MBELDEF. Hayes told her that she was not to call Robinson anymore, and that he would now be the point of contact for Robinson.

Calvin Jenkins, Associate Administrator, One Stop Capital Shop, SBA, also expressed his concerns about MBELDEF and the co-sponsorship agreement to Hayes. Jenkins alerted Hayes that MBELDEF did not have the expertise or workforce to handle the co-sponsorship agreement. Despite his warnings, Hayes directed Jenkins to "make it work." Jenkins stated that problems with the co-sponsorship agreement increased on a daily basis after the agreement was signed. He drafted a memorandum to Hayes, dated March 12, 1999, regarding the status of the co-sponsorship agreement. In that letter, Jenkins outlined the problems with the co-sponsorship agreement, and recommended that it be cancelled. Hayes refused to heed Jenkins' recommendation.

IV. Violation of Law Governing the Use of Appropriated Funds

A. Allegation: It was alleged that funds appropriated for the SDB program were used for non-SDB purposes.

Findings: The allegation was substantiated by an audit conducted of SDB funding and expenditures. (Audit of Small Disadvantaged Business Certification Program Obligations and Expenditures, Audit Report No. 00-19)

B. Allegation: It was alleged that Hayes awarded a contract to Research Planning, Inc. (RPI), to establish a business assessment tool for the benefit of the Section 8(a) program and a second contract to upgrade the executive information system for the SBA MED program. Gutierrez alleged that, although these contracts were funded with SDB monies, they had no connection with and did not benefit the SDB program.

Findings: The allegation was substantiated. (Audit of Small Disadvantaged Business Certification Program Obligations and Expenditures, Audit Report No. 00-19)

C. Allegation: It was alleged that Hayes authorized expenditures from SDB funds for non-SDB training conferences.

Findings: The allegation was substantiated. (Audit of Small Disadvantaged Business Certification Program Obligations and Expenditures, Audit Report No. 00-19)

D. Allegation: It was alleged that Hayes awarded two contracts to the African American Small Business Exporters Association (AASBEA) using SDB funds. According to Gutierrez, these contracts had nothing to do with the SDB program.

Findings: During an OIG interview, Gutierrez clarified his earlier allegation and advised instead that Hayes directed RPI to subcontract work to AASBEA. Gutierrez added that Gwendolyn Flowers, a former GC&MED employee, would be able to confirm his allegation. This allegation was not substantiated.

Flowers did not corroborate Gutierrez' allegation. Flowers explained that she was made aware of AASBEA's expertise by William Fisher, Gutierrez' predecessor. Flowers felt that it would be inappropriate for her to recommend a subcontractor directly to RPI. Instead, she asked Gurley, OA, to advise RPI that AASBEA had in-house expertise that may be of value to them. Flowers stated that Gurley contacted RPI and passed on the information. Gurley confirmed Flowers' statements.

The allegation regarding the use of SDB funds for this contract was substantiated. (Audit of Small Disadvantaged Business Certification Program Obligations and Expenditures, Audit Report No. 00-19)

E. Allegation: It was alleged that Hayes misdirected funds into the 8(a) program.

Findings: This allegation was substantiated. (Audit of Small Disadvantaged Business Certification Program Obligations and Expenditures, Audit Report No. 00-19)

D

**Audit Of
Small Disadvantaged Business Certification
Program Obligations and Expenditures
Audit Report No. 00-19**

This report may contain proprietary information subject to the provisions of 18 USC 1905 and must not be released to the public or another agency without permission of the Office of Inspector General.

Audit of Small Disadvantaged Business
Certification Program Obligations and Expenditures

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U.S. Small Business Administration
Office of Inspector General
Washington, DC 20416

AUDIT REPORT
Issue Date: June 30, 2000
Number: 00-19

TO: James C. Ballentine, Associate Deputy Administrator for
Government Contracting & Minority Enterprise Development

Joseph P. Loddo, Chief Financial Officer

FROM: Robert G. Seabrooks, Assistant Inspector General
for Auditing

SUBJECT: Audit of Small Disadvantaged Business Certification Program Obligations and
Expenditures

Attached is a copy of the subject report. The report contains two findings and four other matters, with ten recommendations to the Associate Deputy Administrator for Government Contracting and Minority Enterprise Development (one of which has already been implemented), and one to the Chief Financial Officer.

The recommendations in this report are subject to review and implementation of corrective action by your office in accordance with existing Agency procedures for audit follow-up. Please provide your management decision for each recommendation made to you within 30 days from the date of this report using the attached SBA Forms 1824, Recommendation Action Sheet.

Any questions or discussion of the issues contained in the report should be directed to Robert Hultberg, Director, Business Development Programs Group, at (202) 205-7204.

Attachments

SUMMARY

The purpose of this audit was to determine whether the Small Business Administration (SBA) used Small Disadvantaged Business (SDB) funds for their intended purpose. The SDB program provides federal procurement benefits to small disadvantaged businesses bidding on federal contracts by giving them up to a 10 percent price preference on their bids. After approval of the Department of Justice and the White House Affirmative Action Working Groups' recommendation that SBA certify all SDBs bidding for Federal contracts. Based on this, 13 Code of Federal Regulations (CFR) 124, Subpart B was published, requiring SBA to certify that small disadvantaged businesses meet specific social, economic, ownership, and control eligibility criteria. The Office of Management and Budget (OMB) determined that the top 20 agencies utilizing SDBs would reimburse SBA for the cost of SDB certification. SBA sent Agency Agreement letters to these agencies, requesting payment. Based on these letters, SBA received \$22.0 million for Fiscal Years 1998 and 1999. We reviewed a judgmental sample of \$13.6 million of the total expenditures and obligations made as of July 31, 1999.

We found that about \$3.0 million of the sampled expenditures and obligations were related to non-SDB certification activities. These unallocable activities included construction and furnishings, equipment, personnel costs, consulting costs, training, and marketing. An additional \$3.2 million for SDB overhead expenditures and development costs for an electronic application system lacked sufficient supporting documentation to enable us to conclude whether the costs were correctly allocated. In addition, SBA cancelled its plans to obligate approximately \$410,000 for a construction project after the auditors questioned the appropriateness of using SDB funds for the project.

We also noted four other areas requiring management action to improve the operation of the SDB Certification program:

- The SDB Certification program was funded through other agencies' voluntary participation in Economy Act Agreements, making the funding for the program unreliable and unpredictable. There was no legal basis that assured the other agencies would continue funding the program.
- The SDB Certification program and supporting offices were overstaffed with SDB funded employees. Some 100% SDB funded employees spent significant amounts of their time on non-SDB work.
- The SDB Certification and Eligibility office did not track its inventory in SBA's electronic inventory management system.
- The SDB Certification and Eligibility office ordered excess equipment that remained in storage for over one year.

We recommend that SBA:

- Adjust the SDB certification charges to other agencies after determining the actual FYs 1998 and 1999 SDB certification costs, factoring in the unallocable expenditures and developing and implementing allocation methodologies that comply with the Economy Act requirements;
- De-obligate all unexpended balances remaining for ineligible obligations;
- Seek a legal basis to require other agencies to reimburse SBA for the SDB certification program;
- Assess future SDB workload requirements and adjust staffing levels accordingly; and
- Inventory furniture and equipment that was acquired with SDB funds and dispose of excess SDB property.

Management agreed with all of the recommendations except the one to seek a legal basis to require other agencies to reimburse SBA. They stated that they have already implemented or are in the process of implementing most of the other recommendations. Their response is summarized and evaluated at the end of each finding. See Appendix C for the full text of Management's May 12, 2000 and June 21, 2000 responses.

The findings in this report are the conclusions of the OIG's Auditing Division based on our review of selected SDB fund obligations and expenditures. The findings and recommendations are subject to review, management decision and corrective action by your office in accordance with existing Agency procedures for audit follow-up and resolution.

INTRODUCTION

A. BACKGROUND

The Small Disadvantaged Business (SDB) program provides federal procurement benefits to small disadvantaged businesses bidding on federal contracts by giving them up to a 10 percent price preference on their bids. The Defense Acquisition Improvement Act of 1986 established the SDB program in the Department of Defense (DOD), the National Aeronautical Space Administration (NASA), and the Coast Guard. The Federal Acquisition Streamlining Act of 1994 expanded the program to all Federal agencies.

The SDB program started out as a self-certification program. Prior to bidding on federal contracts, companies self-certified themselves as small and disadvantaged. However, after the Supreme Court's decision in *Adarand Constructors, Inc. v. Peña*, 115 Sup. Ct. 2097 (1995), the Department of Justice (DOJ) evaluated all federal procurement programs that used race-based criteria. Based on this review, DOJ recommended that small disadvantaged businesses be pre-certified by the government prior to receiving federal contracts in order to withstand court challenges to the program.

The Office of Management and Budget determined that the 20 top agencies would reimburse SBA for the cost of certifying SDBs. SBA sent Agency Agreement letters to these 20 agencies in Fiscal Years (FY) 1998 and 1999 requesting reimbursement for its costs. As a result of these letters, SBA received \$11.3 million and \$10.7 million as advance payments for SDB certifications in FY 1998 and 1999, respectively. The transfer of funds was authorized under the Economy Act, which provides authority for agencies to place orders with other agencies and to transfer funds to pay for the goods or services ordered. SBA established the Small Disadvantaged Business Certification and Eligibility office in 1998 and published regulations for the program in 13 CFR 124, Subpart B. SBA was responsible for (1) certifying small disadvantaged businesses, (2) resolving protests regarding SDB status, (3) overseeing a network of private certifiers, and (4) maintaining a database of certified SDBs.

B. AUDIT OBJECTIVE AND SCOPE

The audit objective was to determine whether SBA used SDB funds for SDB certification purposes. In instances where SBA did not properly allocate costs, we determined the correct allocation based on the SDB program's proportionate share of the total costs of the activity or event. We reviewed a judgmental sample of obligations from inception of the SDB certification function at SBA in 1998 to July 31, 1999. We also reviewed the obligation for MEDWeek '99, which was obligated and expended after July 31, 1999; and overhead charges for FYs 1998 and 1999, which extended beyond July 31, 1999. Additionally, we interviewed officials in the following offices: SDB Certification and Eligibility, Human Resources, Communications & Public Liaison, Administration, Government Contracting & Minority Enterprise Development (GC&MED), General Counsel (OGC), Chief Financial Officer (OCFO), Chief Information Officer (OCIO), and the Office of Management and Budget (OMB).

With the exception of the items discussed below, the sample included all obligations over \$100,000 through July 31, 1999, and certain obligations identified as "questionable" in the audit survey. We excluded obligations to the Minority Business Enterprise Legal Defense Fund co-sponsorship (MBELDEF) from our sample since the SBA Office of Inspector General (OIG)/ Investigations Division was reviewing activities related to these expenditures. We did not audit SDB reimbursements to the OIG for SDB related audits and investigations. Rather, we requested that the Department of Health and Human Services (HHS) OIG review the SBA OIG overhead allocation methodology. See Appendix B for the HHS OIG report.

The fieldwork was conducted from July 7, 1999 to September 24, 1999. The audit was conducted in accordance with Government Auditing Standards.

RESULTS OF AUDIT

Finding A: Certain Obligations And Expenditures Were Ineligible For SDB Reimbursement

Of the \$13.6 million in obligations that we reviewed (as recorded by the OCFO), expenditures of \$2,098,827 and unexpended obligations of \$868,150 were ineligible to be paid with SDB funds. This is because the costs were not related to SDB certification and eligibility, or the costs were not properly allocated between the SDB certification function and the other program(s) receiving benefits, as required by the Economy Act. Based on the Agency Agreement letters, SBA was reimbursed for the cost of "SDB certifications." SDB funds were used for non-SDB certification and eligibility purposes as defined by the Federal Register dated June 30, 1998 and the letter accompanying the Interagency Agreement that SBA sent to the 20 agencies.

Funds for SBA to conduct SDB certifications were transferred from other agencies under the Economy Act. Comptroller General Decision, B-250377 (January 28, 1993), states that an agency filling an Economy Act order must ensure that it is reimbursed for its actual cost without augmenting its appropriations. Actual cost includes all direct costs attributable to providing the goods or services ordered, as well as indirect costs that bear a significant relationship to providing the goods or services. SBA's written guidance on the purpose of SDB certification funds was a one sentence statement in the Interagency Agreements that stated "Enclosed is the Fiscal Year 1998/1999 Interagency Agreement (SF 1081) form to accomplish the transfer of funds required for the U.S. Small Business Administration (SBA) to perform certification under the Small Disadvantaged Business Program."

The use of SDB funds on other SBA programs would augment SBA's appropriation, in violation of the Economy Act and Appropriations Law. (General Accounting Office Redbook: Appropriations Law-Vol. II, Chapter 6, Section E, *Augmentation of Appropriations*.) The law prohibits agencies from augmenting their appropriations from outside sources without specific statutory authority. Various programs and offices that received goods or services paid for with SDB funds, e.g. 8(a), HUBZone Empowerment Contracting (HUBZone), Government Contracting (GC), OGC, OCIO, and Office of Administration, receive their own funds within the SBA appropriation. The Economy Act governs the process when Federal agencies place orders with other Federal agencies and are reimbursed for such services. In this situation, the funds were limited to the responsibilities listed in the Federal Register dated June 30, 1998, page 35771: (1) certifying SDBs, (2) resolving protests regarding SDB status, (3) overseeing a network of private certifiers, and (4) maintaining a database of certified SDBs. Examples of ineligible obligations and expenditures are discussed below. See Appendix A for a listing of all questioned obligations and expenditures.

Construction and Furniture

- Government Contracting & Minority Enterprise Development (GC&MED) Offices on the 8th Floor of the WOC – The planned renovation of the non-SDB certification portions of GC&MED (including converting the Eisenhower Conference Room into GC&MED offices) totaling \$535,947 was ineligible to be paid with SDB funds because it was not required for SDB purposes. An additional \$410,000, which was to be obligated for the GC&MED office renovation, was canceled one week prior to its scheduled start date, after the auditors questioned the ADA/GC&MED's intent to use SDB funds for the renovation.
- Desk Chairs - Two hundred forty (240) desk chairs were purchased although the SDB budget allotted only 122 SDB funded FTEs. The \$56,758 expended for the 118 desk chairs in excess of the 122 needed for the SDB program was not allocable.

Equipment

- In-Line Binder – The \$92,294 obligation for an in-line binder was wholly not allocable since SDB did not have a bona-fide need for this equipment as the binder has only been used to bind non-SDB related products. This equipment was located in SBA's print shop and was available for SBA's general use.
- Other Equipment – Obligations and expenditures for computers, printers, copiers, cell phones, and fax machines purchased for non-SDB purposes or for personnel or offices with multiple responsibilities in addition to SDB certification, should not have been fully paid with SDB funds. Certain equipment was assigned to employees or offices with no SDB affiliation, and therefore, was an ineligible SDB expense. In other instances, more equipment was purchased than needed for SDB certification, e.g., SDB funds paid for 142 computers when there were 122 FTEs budgeted for SDB certification. Other equipment was assigned to employees or offices overseeing SDB certification as well as other programs, making portions of the expense not allocable. For example, all the programs the ADA/GC&MED has responsibility for should have paid for the copier located in his office suite, rather than having SDB funds pay for its entire cost. In total, we determined that equipment obligations totaling \$126,470 were not allocable to the SDB program.

Compensation and Benefits

Compensation and benefits paid to two employees were either wholly or partially ineligible for reimbursement from SDB funds. The compensation and benefits for both employees were paid entirely with SDB funds. One employee worked on the Mentor-protégé program, which is unrelated to SDB certification, therefore the entire compensation and benefits paid to this individual were ineligible. The other employee had communications responsibilities over six areas, only one of which was allocable to the SDB funds. Therefore, five-sixths of this

individual's compensation and benefits were ineligible. For the two employees, a total of \$122,235 was ineligible.

Consulting, Training, and Marketing

Certain consulting, training and marketing obligations and expenditures were either wholly or partially ineligible for reimbursement from SDB funds since they were wholly or partially unrelated to SDB certification. Ineligible obligations and expenditures totaled \$2,033,273.

- Software and Systems Consulting - A disproportionate share of these expenses were paid with SDB funds. In some instances, the entire project was unrelated to SDB certification. In other instances, SDB paid more than its share of the total cost.
- Training events - Two of these events provided benefits to multiple SBA programs, but SDB paid the entire expense.
- MedWeek - MedWeek '98 and MedWeek '99 provided benefits to multiple programs, but SDB paid a disproportionate share of the total cost.

Recommendations

We recommend that the Associate Deputy Administrator/Government Contracting & Minority Enterprise Development:

- A01: Instruct the Chief Financial Officer to adjust the SDB certification charges to other agencies after determining the actual FYs 1998 and 1999 SDB certification costs, factoring in the unallocable expenditures (see Appendix A) and developing and implementing allocation methodologies (see recommendation B03). If the amount collected exceeds the actual cost, the CFO should be instructed to return the excess collected to the other agencies. If the actual cost exceeds the amount collected, the CFO should be instructed to collect additional funds from these agencies;
- A02: Instruct the Chief Financial Officer to de-obligate the unexpended balances remaining for ineligible obligations (see Appendix A);
- A03: Develop and implement guidelines detailing when SDB funds can be used; and
- A04: Not use SDB funds for office renovations unrelated to SDB certification. This recommendation has already been implemented.

SBA Management's Response:

Management agreed with the four recommendations contained in this finding and that \$2.959 million in questioned items that were not allocable to the SDB program. They disagreed with the draft report finding that certain construction and furniture costs for the 8th floor of the Washington Design Center (WDC) and the 2nd and 5th floors of the Washington Office Center (WOC) should not be paid with SDB funds. The draft report questioned costs for those areas that were not to be occupied by SDB employees (these items have been deleted in the final report after the OIG evaluated Management's response). Management's rationale was that there were 122 SDB funded FTEs, and they constructed offices and cubicles for 122 employees. In doing so, these offices caused a displacement of non-SDB employees. They explained that it was appropriate to design the 8th and 5th floor office suites as they did, with some offices being for non-SDB funded employees. See Appendix C for the full text of Management's response.

OIG Evaluation of Management's Response:

While Management agreed to implement our recommendations, they did not detail what was included in their "agreed upon questioned items" totaling \$2.959 million, which was approximately \$8,000 less than the \$2.967 million we questioned in this report. We accepted Management's statement that the difference represented "timing adjustments," i.e., increases or decreases of obligations and expenditures after our audit cut-off date.

Based on Management's response, we have re-evaluated our audit results for constructing and furnishing the 8th floor of the WDC and the 5th and 2nd floors of the WOC. We accepted Management's response that it built workstations to house the additional 122 new FTEs that it expected to hire and that it was not relevant who occupied the new workstations, as long as all the new SDB employees were provided work stations within SBA. Accordingly, we have revised the final report by reducing our questioned costs by \$523,213, to \$2,966,977.

While we did not question the allocability of the \$523,213, we believe that better planning and communication could have reduced the renovation costs. SBA Management appeared to have been very concerned on the need to accommodate 122 employees, without a corresponding concern to monitor the activities to reduce space requirements prior to and during various phases of construction. SBA built offices for the 122 budgeted SDB funded positions without determining where each of the SDB funded employees (to be located in seven different offices throughout the building) would be located. Had SBA determined where each of the 122 SDB funded employees were to be located before construction began, we believe that there was an opportunity to reduce the total space actually constructed and furniture purchased with SDB funds. One office, which had six of the 122 budgeted FTEs, orally communicated to a GC&MED official prior to the beginning of any construction that it would not be hiring any new employees, reducing the number of work stations needed by six. Another office did not plan on hiring its five budgeted SDB funded employees until the need arose, thus indefinitely postponing the need for five additional workstations. Apparently, the GC&MED official did not communicate either of these developments to Administrative Services so that space requirements

could be adjusted downward. Given the requirements of the Economy Act to be reimbursed for actual costs needed for the SDB program, better monitoring of staffing and space requirements was needed.

Further, SBA was not prudent in its use of SDB funds to purchase certain new office furniture. Fourteen non-SDB funded OGC employees were scheduled to be co-located with the SDB attorneys in SDB funded space. Though some of these 14 employees had furniture in the offices they were vacating, all the workstations received new furniture paid for with SDB funds, at an average cost of over \$7,500 per workstation. While these furnishings are included in building and furnishing office space for the 122 SDB funded positions, SBA could have reduced SDB expenses by moving these on-board employees with their existing furniture and only charging SDB funds when there was an actual need for new furniture.

Management's response contained some additional comments that we addressed in Appendix D to clarify our position.

Finding B: Unsupported Distribution of Overhead and Electronic Application System Costs Charged to the SDB Certification Program

The Office of the Chief Financial Officer (OCFO) charged \$2.8 million in overhead to SDB funds for FYs 1998 and 1999 based on unsupported percentages. SDB funds also paid the entire \$446,634 expenditure for an electronic 8(a)/SDB application system, though both the 8(a) and SDB Certification programs were to receive benefits from the system. SBA needs to develop a cost allocation methodology so that the SDB expenses can be properly supported.

Overhead Expenses

The OCFO applied 15 percent and 10 percent of funds transferred from other agencies to overhead in FY 1998 and FY 1999, respectively, without determining what expenses constitute overhead or whether these percentages represented SDB's proper share of actual SBA overhead costs. The Deputy CFO and a budget officer stated that SBA applied the same overhead rate to the SDB program as the Disaster Assistance program. Without an established overhead cost allocation methodology and structure, SBA cannot determine whether it properly charged other agencies for the actual cost of SDB certifications as required by the Economy Act.

OCFO officials stated that SBA did not perform an overhead cost allocation study because they were confident that SBA incurred more than 15 percent and 10 percent overhead. However, they had not conducted any analyses to support this conclusion. In Management's response to the draft report, they stated, "Because the SDB certification program was new, SBA could only estimate what the indirect costs to the program should be." OCFO has recently completed an agency-wide cost allocation study for FY 1999 to provide support for SBA's overhead charges.

Electronic 8(a)/SDB Application System

A portion of the cost to develop an electronic 8(a)/SDB application system, all of which was paid with SDB funds, was an ineligible SDB expense. According to SBA's Director of Information Systems Support (ISS), one portion of this work was unique to the 8(a) program, another was unique to the SDB Certification program, and the rest was common to both programs. We could not determine the relative portion of each based on ISS' existing supporting documentation. Since the 8(a) and SDB Certification programs were to both benefit from this application system, SDB funds should not pay for all of the development costs.

Recommendations

- B01: We recommend that the Chief Financial Officer coordinate with the Associate Deputy Administrator/Government Contracting & Minority Enterprise Development to identify all direct and indirect costs chargeable to the SDB fund, and develop and implement an allocation methodology to allocate overhead for the SDB Certification program that meets the requirements of the Economy Act.
- B02: We recommend that the Associate Deputy Administrator/Government Contracting & Minority Enterprise Development coordinate with the Chief Information Officer to develop and implement an allocation methodology that reasonably allocates the cost of the electronic 8(a)/SDB application system between the 8(a) and SDB Certification programs.
- B03: We recommend that the Associate Deputy Administrator/Government Contracting & Minority Enterprise Development direct the Chief Financial Officer, based on the results reached from implementing recommendations B01 and B02, adjust the charges to SDB for the FY 1998 and FY 1999 overhead and the 8(a)/SDB application system.

SBA Management's Response:

Management agreed with the three recommendations contained in this finding, stating that they have completed the FY 1999 cost allocation study, and the results of that study will justify the FY 1998 and FY 1999 charges. They did not believe that the percentages used to charge the agencies for indirect costs were "arbitrary and unsupported," but were derived based on historical percentages of overhead costs for other SBA programs. Management also stated that they are in the process of devising a cost allocation method to allocate the costs of the electronic 8(a)/SDB application system. See Appendix C for the full text of Management's response.

OIG Evaluation of Management's Response:

Management has implemented recommendation B01. We modified the report to take out the term "arbitrary" in describing the percentages used for charging overhead. Since SBA had not performed any analysis of the expected SDB related overhead charges at the time the charges were made, the finding remains that these percentages were unsupported. The FY 1999 cost study found that the FY 1999 overhead rate was 34 percent of direct costs.

Finding C: Other Areas Requiring Management Action to Improve Operation of the SDB Certification Program

Funding for the SDB Certification Program was Unreliable

Because there is no law or executive order that requires other Federal agencies to enter into the Economy Act agreement with SBA to reimburse SBA for certifying SDBs, these Federal agencies could elect to not participate in the Economy Act agreement and not pay SBA. The FY 1998 and FY 1999 funds were transferred from individual agencies to SBA pursuant to SBA's request for these funds. This arrangement may not support the SDB Certification program in the future. The Defense Information System (Department of Defense agency) did not pay SBA its FY 1999 assessment, the Tennessee Valley Authority (TVA) did not pay its FYs 1998 and 1999 assessments, and NASA did not pay its FY 1998 assessment until FY 1999.

SDB Certification Program and Supporting Offices were Overstaffed

While the actual number of SDB applications was 11 percent of the amount estimated, SBA did not adequately adjust the SDB Certification and Eligibility workforce to parallel this reduced workload. Further, some 100 percent SDB funded employees in other SBA offices were not spending all of their time on SDB functions.

[FOIA Exemption (b)(5)] a prior SBA Comptroller established the "51% rule" that states that if at least 51% of the object whose funding is proposed supported a particular program, that program's appropriations can be charged for the entire cost. SBA applied this rule to the SDB program and charged 100% of certain employees' compensation and benefits to the SDB funds if these employees devoted at least 51% of their time on SDB work. The OCFO was reviewing the validity of this guidance.

- The SDB Certification and Eligibility office requested 80 FTEs to process the 30,000 SDB applications SBA estimated would be received each year. While SBA received 3,153 applications through September 30, 1999, it had 59 FTEs on board at 10/12/99, down from a high of 64 FTEs. Under the original budget estimate, approximately 375 applications would be processed for each FTE on board (30,000/80). Assuming each employee processed 375 applications per year, 9 SDB Certification and Eligibility employees would have processed the 3,153 applications actually received. Although SBA received far fewer SDB applications than anticipated during its first year, and the monthly numbers did not indicate a significant upward trend, SBA had not adequately reduced the SDB Certification and Eligibility office's workforce to

each employee processed 375 applications per year, 9 SDB Certification and Eligibility employees would have processed the 3,153 applications actually received. Although SBA received far fewer SDB applications than anticipated during its first year, and the monthly numbers did not indicate a significant upward trend, SBA had not adequately reduced the SDB Certification and Eligibility office's workforce to compensate for this diminished workload. Management stated that they did not reduce the staffing levels at the time of our audit fieldwork since the deadline for subcontractors to be certified was pushed back to October 1, 1999 (after our fieldwork ended), and that SBA anticipated a major increase in applications once the subcontracting certification requirement became effective. They stated that after this anticipated increase did not occur, they immediately began reducing their staff, and based on the workload, will continue to do so.

- On average, the 16 attorneys in OGC who were 100 percent funded by SDB, estimated they spent 65 percent of their time working on SDB related issues.
- Two of the 100 percent SDB funded Office of Chief Information Officer (OCIO) employees spent 50 and 51 percent of their time supporting the SDB program. These employees were assigned to help develop, implement, and maintain the SDB tracking system and the electronic 8(a)/SDB application system. The SDB tracking system has been completed and implemented, and no further work is planned to complete implementation of the electronic 8(a)/SDB application system. One of these individuals indicated that he has not worked on SDB-related issues since March 31, 1999.
- Human Resources (HR) employed two SDB funded employees. One of these employees was a supervisor who provided part-time support to SDB, devoting approximately 60 percent of her time to SDB related matters during the time she was employed at SBA.

SDB Furniture and Equipment was not Inventoried

The SDB Certification and Eligibility office did not inventory its furniture and equipment in the Fixed Asset Accountability System (FAAS), an Agency-wide inventory system for managing property. SOP 00-13-4 requires all inventory valued at \$50 or more to be labeled and tracked in FAAS. Although a staff assistant was assigned to oversee inventory, this individual did not maintain any inventory records and was not familiar with SOP 00-13-4. As a result, SDB officials did not know where some furniture and equipment were located, e.g., 38 desk chairs.

SDB Certification Program Purchased Excess Equipment

The SDB Certification and Eligibility office purchased excess SDB equipment that remained in storage for over one year. Some equipment items, like computers, become obsolete

over time. SOP-00-13-4, Chapter 3, *Excess Property*, requires the disposal of excess property by finding others within SBA or from another agency that could use the property. The former Acting ADA/GC&MED stated that a consultant helped SBA with the logistics and determined the amount of equipment to purchase. Management stated that they did not surplus excess equipment since the deadline for subcontractors to be certified was pushed back to October 1, 1999 (after our fieldwork ended), and that SBA anticipated a major increase in applications once the subcontracting certification requirement became effective and the results of its intensive marketing efforts were realized. They believed that it was prudent not to dispose of this equipment until it was clear that applications would not significantly increase and additional staff would not be hired. This anticipated increase did not occur, and was acknowledged after the end of the fieldwork portion of this audit. The auditor noted the following equipment that was kept in storage for over one year:

- Five computers;
- Eight computer monitors;
- One scanner;
- One fax machine;
- Four cell phones; and
- Seventeen pagers.

Recommendations

We recommend that the Associate Deputy Administrator/Government Contracting & Minority Enterprise Development:

- C01: Seek a basis to require mandatory reimbursement from other agencies to fund the SDB Certification program through an executive order or amendments to the Federal Acquisition Regulations.
- C02: Assess future SDB workload requirements with appropriate offices employing SDB funded employees and adjust staffing levels accordingly.
- C03: Ensure that all SDB equipment valued over \$50 is inventoried through the FAAS.
- C04: Assess whether any SBA offices can use some or all of the excess SDB equipment and if so, "sell" them the equipment. If a need cannot be identified, notify GSA to make the equipment available to others.

SBA Management's Response:

Management disagreed with recommendation C01, stating that the Economy Act provided sufficient legal authority to seek reimbursement from other agencies, therefore, additional legal authority was not required. They agreed with recommendations C02, C03 and

C04. Management disagreed with our findings related to overstaffing and disposing of excess equipment, stating that they did not reduce staffing or excess equipment earlier because SBA anticipated a major increase in applications once the subcontracting certification requirement became effective. See Appendix C for the full text of Management's response.

OIG Evaluation of Management's Response:

In their response to recommendation C01 concerning obtaining a legal basis to require mandatory reimbursement from other agencies to fund the SDB Certification program, Management did not address the voluntary nature of the agreement between the parties. Since SBA and other agencies enter into the Economy Act agreement on a voluntary basis, SBA could not require the other agencies to pay their share of the SDB assessment if the other agencies opted not to sign the Economy Act agreement. We did not intend to convey that there was no legal authority that permitted this kind of reimbursable agreement, but rather that there was no legal basis which ensured that SBA received funding to carry out SDB certifications if the other agencies decided not to sign the Economy Act Agreement. We have modified the language in the final report to clarify this issue.

We added Management's explanations of why they did not reduce staffing levels or dispose of equipment earlier to the body of the report. Concerning excess equipment, the SDB program should not have purchased more equipment than it could have reasonably used during the fiscal year that the purchases were made. For example, 142 computers were purchased although the budgeted SDB staffing level was 122 FTEs.

INELIGIBLE OBLIGATIONS

Description	Obligated Amount	Expenditures Not Allocable	Unexpended Obligations Not Allocable
CONSTRUCTION AND FURNITURE			
8 th floor GC&MED construction & furniture		\$ 128,398	\$ 464,307
240 Desk chairs (8.6368.0320)	A 535,947	71,640	464,307
	115,381	56,758	0
EQUIPMENT			
1 In-line binder (8.6368.0322)		\$ 208,973	\$ 9,791
4 Model 230 SLX copiers (8.6368.0350)	92,294	82,660	9,634
1 Model 230 SL copier (8.6368.0309)	76,124	18,216	0
142 Computers (8.6368.0303, 8.6368.0312, 8.6369.0013)	20,125	14,518	0
18 Printers (8.6368.0303, 8.6368.0312)	282,959	39,860	0
2 Computer servers (8.6368.0398)	31,016	5,220	0
2 High-performance computers (8.6368.0400, 8.6368.0401)	12,610	12,610	0
12 Laptop computers (8.6368.0399)	13,926	13,769	157
13 Cell phones (8.6368.0336)	28,846	16,282	0
6 Fax machines (8.6368.0325)	5,960	720	0
	10,236	5,118	0
COMPENSATION AND BENEFITS FYS 98 and 99 to 7/31/99			
		\$ 122,235	\$ 0
CONSULTING, TRAINING AND MARKETING			
SSSI consulting - task order #5 (8.5464.0005B2)		\$1,639,221	\$ 394,052
RPI consulting (8.6368.0412)	64,998	64,998	0
Paradigm consulting (8.6368.0413)	649,839	345,461	304,378
Seta consulting - New Markets (8.6369.0005)	249,400	194,458	54,942
Seta consulting - Contracting Mall (9.6368.0134)	6,710	0	6,710
Seta consulting - Task order #5 (8.5464.0004, 9.5464.0016)	7,500	0	7,500
Seta consulting - Task order #3 (8.5464.0004)	133,810	125,000	8,810
Seta consulting - Business and IT plans (9.6369.0006)	B 425,482	263,721	697
ASD consulting (8.6368.0334)	22,030	0	11,015
Crystal City Hilton training (9.6368.0140)	46,000	46,000	0
Lansdowne Resort training (8.6368.0327)	B 46,763	35,072	0
Lansdowne Resort travel (8.6368.G331)	396,038	297,029	0
Betah consulting (8.6368.0343)	B 114,432	85,824	0
MEDWeek '98 (8.6364.0015A)	63,315	31,658	0
MEDWeek '99 (9.6368.0185)	200,000	50,000	0
	200,000	100,000	0
TOTAL		\$ 2,098,827	\$ 868,150

A - Construction contracts covered multiple areas, therefore, auditor calculated the portion chargeable to specific areas by multiplying the total contract cost by the ratio of square footage in a particular area divided by the total area covered by the contract.

B - Figure represents the expended amount. Since the obligation was higher than the expended amount, and SBA can use the unexpended balance for SDB related expenses, our review was limited to the amount expended.



RECEIVED
DEC 6 4 22 PM '99
DEC 2 1999

Peter L. McClintock
Deputy Inspector General
Office of Inspector General
Small Business Administration
409 Third Street, SW
Washington, DC 20416

Dear Mr. McClintock:

As requested, we performed agreed-upon procedures to evaluate the reasonableness of the methodology used by the Small Business Administration, Office of Inspector General (SBA-OIG) to determine hourly rates used to allocate the costs of audit, investigative and other services performed by the SBA-OIG to various appropriations and reimbursable activities (allocation rates). This letter provides you with the results of this evaluation.

The objective of performing the agreed-upon procedures was to determine the reasonableness of the methodology used by the SBA-OIG to develop equitable cost allocations for various SBA activities. Our work was limited to a review of the formula used by the SBA-OIG to calculate the allocation rates for Fiscal Years 1999 and 2000. We did not assess the validity of underlying data used in calculating the allocation rates, which would include such information as the number of direct hours or amount of total expenditures incurred by the SBA-OIG. The information contained in this letter is intended solely for the internal use of the SBA-OIG.

For each SBA-OIG division performing direct services (i.e., Auditing, Investigations, Investigations-Security and Inspections) an allocation rate is determined by a formula that divides total direct and indirect expenditures (compensation, benefits and allocated overhead) by direct hours incurred to arrive at a "cost per hour." A separate rate is calculated for each SBA-OIG division.

We reviewed the methodology used by the SBA-OIG to calculate an allocation rate for each of its divisions. Based on this review, we believe the methodology used results in allocation rates that accurately reflect the total direct and indirect costs of audit, investigative and other services performed by the SBA-OIG. Because we did not review the underlying data, our opinion is limited only to the reasonableness of the allocation method.

Page 2 - Mr. McClintock

We hope that this information is responsive to your request. Please let me know if you have any questions or require any additional information.

Sincerely,

A handwritten signature in cursive script that reads "Joe B. Rankin". The signature is written in black ink and is positioned above the printed name and title.

Joe B. Rankin

Director

Human and Financial Resources



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

DATE: May 12, 2000

TO: Robert G. Seabrooks
Assistant Inspector General for Auditing

FROM: James C. Ballentine, ADA/GC/MED *James C. Ballentine*
Joseph P. Loddo, Chief Financial Officer *Joseph P. Loddo*

SUBJECT: Draft Audit of SDB Certification Program
Obligations and Expenditures

This is in response to the draft Audit of Small Disadvantaged Business (SDB) Certification Program Obligations and Expenditures conducted by the Office of Inspector General (OIG). In responding to the draft audit, we have followed the format of the audit report. All titles are taken from the report.

SUMMARY

The purpose of this Agency initiated audit, as explained by the OIG, was "to determine whether the SBA used SDB funds for their intended purpose." After investigating expenditures made with SDB funds, the OIG concluded that \$3.5 million of the sampled expenditures and obligations were used for non-SDB certification purposes. These allegedly unallocable expenses were for construction, furnishings, equipment, personnel, consulting, training, and marketing. For the reasons discussed below, we disagree with the OIG's conclusions with regard to construction and certain furnishings, and are continuing to analyze the other cost allocations. We will give an even more detailed assessment of the Agency's conclusions regarding all costs in our response to the final audit report.

In addition to its findings with regard to specific expenditures, the OIG expressed the view that four areas required management action to improve operation of the SDB certification program. Those areas were the lack of legal authority to assure continual funding for the SDB certification program; the overstaffing of employees charged to the SDB program; the lack of inventory tracking; and the storage of equipment for excessive amounts of time. For the reasons discussed below, (1) we believe that additional legal authority is not needed to operate the SDB certification program; (2) we agree that the staffing level of the SDB program needs to be continually assessed and adjusted based on actual workload, but, when made, staffing decisions were appropriate; (3) we accept the

OIG's conclusions regarding failure to track inventory adequately; and (4) we disagree with the OIG's conclusion that it was inappropriate to store equipment for over a year.

The OIG made a number of recommendations, including:

- (1) adjust SDB certification charges after determining Fiscal Year (FY) 1998 and 1999 SDB certification costs, factoring in the unallocable expenditures and developing allocation methodologies that comply with the Economy Act requirements;
- (2) de-obligate all unexpended balances remaining for ineligible obligations;
- (3) seek legal authority to require reimbursement from other agencies to fund the SDB certification program;
- (4) assess future SDB workload requirements and adjust staffing levels accordingly; and
- (5) inventory furniture and equipment that was acquired with SDB funds and dispose of excess SDB property.

It is important to note that the OIG draft audit report includes none of the explanations or reasons given by SBA management for charging various items to the SDB funds. Nor does the report describe the conditions under which these decisions were made. The absence of such explanations and conditions results in a strong impression of wrongdoing or bad faith. We strenuously object to any inference that there was any bad faith involved in SBA's decisions to allocate costs to the SDB funds under the Economy Act. Because the SDB certification program was new, SBA could only estimate what the indirect costs to the program would be. Moreover, all parties concerned, including the Office of Management and Budget and the White House Affirmative Action Working Group (an interagency group), believed that SBA would receive considerably more certification applications, requiring a much larger staff, larger facilities, and more equipment than has so far proved to be the case. Thus, looked at in this context, it is understandable and inevitable that adjustments must be made as the program matures. We are firmly convinced that all decisions have been made in good faith and in the firm belief that the funding allocations were justified, legal, and appropriate.

With respect to the specific OIG recommendations, we agree with the first recommendation. In fact, the Office of the Chief Financial Officer (OCFO) is currently reexamining all funding of SDB certification and related expenditures. This examination includes costs allocated to the SDB funds as well as costs charged to SBA's appropriations related to SDB certification services. An activity-based cost accounting study commissioned by SBA for FY '99 (discussed below) indicated that in FY '99, SBA incurred additional costs outside those directly charged to the SDB funding. (A copy of the cost study has already been provided to the OIG and several discussions have been held with OIG staff on the study.) OCFO is committed to using cost allocation studies in

the future to assign and allocate costs. In fact, in the latest meeting with the OIG staff on Monday, May 8, 2000, the OIG concluded that the cost allocation study "can be acceptable support for SDB reimbursement under the Economy Act."

With regard to recommendations (2) and (3), we will continue to reexamine all charges against the SDB account and to de-obligate any necessary and appropriate amounts. \square FOIA Ex- (b)(5) the Economy Act provides sufficient authority to allow SBA to operate the SDB program and receive reimbursement from the participating agencies. We do not believe additional authority is necessary.

We agree with the OIG in recommendation (4) that SBA should assess future SDB workload requirements and adjust staffing levels accordingly. In fact, that effort is well underway, and staffing levels have already been significantly reduced. Finally, we agree with the OIG's recommendation (5) that all furniture and equipment acquired with SDB funds be inventoried and that excess property be disposed of. That effort is also in process and should be completed soon.

BACKGROUND

In response to the Supreme Court's decision in Adarand Constructors, Inc. v. Peña, 115 Sup. Ct. 2097 (1995), the Clinton Administration vowed to "mend not end" affirmative action. An initial response to this initiative was to establish the SDB/Certification and Eligibility program. SBA, the Department of Justice (DOJ) and the Administration developed the SDB certification program to satisfy the strict scrutiny requirements of Adarand. The goal was to establish an SDB contracting program that measured the effects of discrimination within particular industries, and certified SDBs through a certification process that also would include outreach, research, educational and oversight activities.

Initially, DOJ suggested that each Agency perform its own SDB certifications. After rethinking the ramifications of this decision, DOJ suggested that the agencies centralize the certification activity to ensure that the Federal government utilize one SDB certification process (consistent with Adarand). This centralized certification process would achieve consistency, reduce costs and administrative burdens, and save the agencies from the time-consuming task of establishing their own certification programs. SBA was the natural choice to centralize this process because of its extensive experience in certifying 8(a) concerns and resolving protests in connection with both the 8(a) and the previous SDB set-aside programs.

As recommended in the DOJ review of federal affirmative action procurement programs, SBA created standards and procedures by which a firm could apply to be recognized as an SDB. In response to the DOJ's review, the Vice President's Office formed the White House Affirmative Action Working Group to, among other things, aid in the creation of the standards and procedures necessary to implement the SDB certification process. The Working Group was comprised of representatives from the White House, the Justice

Department, OMB, and other agency representatives as appropriate (e.g., SBA, Transportation, Defense, Commerce). Due to the uncertainty of the number of actual SDB subcontractors (lack of adequate data), it was initially estimated that SBA would require 888 full time equivalent employees and a projected annual cost of \$72,584,251.00 to process applications from approximately 160,000 potential SDBs. However, OMB did not approve such a high initial cost estimate, reasoning that such an estimate would deter procuring agencies from participating financially. Several alternative proposals were introduced and eventually the Working Group agreed to a projection of 30,000 potential SDBs and a requirement for 122 FTEs spread amongst various offices at SBA. OMB approved these projections, which at the time were considered extremely conservative by the Working Group.

Using the projected number of SDB applications, SBA prepared for the surge of SDB certification applications it expected to receive. These plans included hiring personnel, purchasing equipment, and locating suitable space to house the team of individuals necessary to implement the program and ensure its viability into the future. Additionally, SBA began its extensive marketing efforts to inform the procurement community and the public of the certification process and its benefits.

RESULTS OF AUDIT

Finding A: Certain Obligations And Expenditures Were Ineligible For SDB Reimbursement

The OIG objected to certain costs that it claimed were ineligible to be paid with SDB funds either because the costs were unrelated to the certification function, or because the costs were not allocated fairly among all benefiting program areas. As pointed out by the OIG, the Comptroller General has held that an agency filling an Economy Act order must ensure that it is reimbursed for its actual cost without augmenting its appropriations. See, e.g., Matter of: Federal Mediation and Conciliation Service—Propriety of Financial Management Service Charges Under the Economy Act, B-257823 (unpub.), 1998 WL 23074 (Jan. 22, 1998). Actual cost includes all direct costs attributable to providing the goods or services ordered, as well as indirect costs funded out of the performing agency's currently available appropriations that bear a significant relationship to providing the goods or services. 31 U.S.C. §1535; 48 C.F.R. Subpart 17.5; SBA SOP No. 90-77, External and Economy Act Agreements, dated Jan. 14, 1994. As a general matter, we agree with the OIG's findings concerning the restrictions on the use of Economy Act funds; however, we disagree with some of their conclusions concerning specific expenditures.

The Economy Act provides authority for Federal agencies to order goods and services from one another. 31 U.S.C. §1535(a). Economy Act funding must reflect the actual cost of the goods or services delivered, both direct and indirect. 31 U.S.C. §1535(b); 48 C.F.R. §17.505. In relevant GAO decisions, GAO has upheld various methodologies to determine the indirect costs of an Economy Act transaction. See Matter of Federal Mediation and Conciliation Service (FMCS)-Propriety of Financial Management Service

(FMS) Charges Under Economy Act, B-257823 (unpub.), 1998 WL 23074 (Jan. 22, 1998)(use of standard hourly rate including indirect costs); David P. Holmes, Acting General Counsel, Central Intelligence Agency, B-250377 (unpub.), 1993 WL 35613 (Jan. 28, 1993).

Agencies are allowed flexibility in allocating obligations among different programs. The GAO states: "There is no rule or formula for this allocation apart from the general prescription that the agency must use a supportable methodology." II Red Book, p. 7-7. GAO will not interfere with reasonably determined internal accounting procedures of an agency. See Matter of: Reimbursements to U.S. Army Corps of Engineers Civil Works Revolving Fund for Costs of Keeping Dredges Idle, B-257064, 1995 WL 153632 (April 3, 1995).

Construction

We conclude that SBA properly allocated the demolition, design and construction of the 8th floor of the Washington Design Center and the 5th floor of the Washington Office Center 100% to the SDB certification funds. The SBA made reasonable space decisions in light of projections by the Working Group that SBA would receive at least 30,000 applications for SDB certification. SBA's reliance on the projected number of applications was reasonable (and therefore, so too was the allocation) for the following reasons:

- Use of PRO-Net Database. These projections were calculated, in part, from the PRO-Net database of self-certified SDBs and women-owned businesses (WOB). Approximately 34,000 SDBs and approximately 5,000 WOBs were listed on PRO-Net. The Working Group assumed that each of these firms, at the very least, would submit an SDB application to SBA. The Working Group assumed that such a figure would double after taking into consideration the possibility of new applicants. This brought early Working Group projections to the 80-100,000 range.
- Evidentiary Standard Change. The Working Group anticipated a large increase in applications from businesses owned and controlled by Caucasian women. This expectation was precipitated by the change in the evidentiary standard required to prove social disadvantage, a direct result of the Adarand decision. Applicants not members of one of the groups presumed to be disadvantaged are now required to show social disadvantage by only a preponderance of the evidence. Formerly, these non-presumed group members were required to prove social disadvantage by clear and convincing evidence by all accounts and based on past experience, a very difficult standard to prove. Thus, the Working Group anticipated that a large number of applications would come in from Caucasian women, who are not members of a group presumed to be disadvantaged for SDB certification purposes.
- End of Subcontractor Self-Certifications of SDB Status. After October 1, 1999, prime contractors seeking to receive credit toward their SDB utilization goals were required to subcontract only with SBA-certified SDBs. Prior to October 1, 1999,

SDBs were able to self-certify their SDB status. SBA reasonably anticipated that after October 1, 1999, the rate of SDB applications coming to SBA for action would dramatically increase.

In essence, SBA, the Working Group, and other participating Federal agencies reasonably anticipated a flood of SDB applications. Due to the anticipated number of at least 30,000 applications and the Agency's good faith belief that the SDB certification program would experience continual growth, the Agency's decisions regarding initial construction for the SDB Program were rational and reasonable at the time they were made. Although the projected number of SDB applications never came to fruition, neither the SBA, the Working Group, nor the other participating Federal agencies could have foreseen this. It is important to keep in mind that the Agency was tasked with setting up a new program with no previous history and within an extremely tight time frame. Given these circumstances, SBA made reasonable decisions to provide sufficient space to enable the SDB program to appropriately and expeditiously handle the anticipated applications.

SBA initially contacted the General Services Administration (GSA) to find a suitable location to house all 122 FTEs. Although GSA located rental space in a distant location, the Agency had concerns about the potential for management problems with so many employees operating away from the main umbrella of the organization. Subsequently, the Agency located adequate space in the adjoining building, the Washington Design Center (WDC), and adequate space on the fifth and second floors of the Washington Office Center (WOC)(SBA's Central Office). The management objectives of centralization and convenience did result in a justifiable ripple effect, with some offices being moved to make space available for the SDB Program. Costs resulting from a ripple effect are attributable and allocable to the program causing the ripple movement. See, e.g., In the Matter of Funding for the Health Resources Administration Move, 56 Comp. Gen. 928 (Aug. 31, 1977). In totality, SBA built a total of 125 work stations, between the 8th floor WDC space and the 5th floor of the WOC, in order to house the approved 122 SDB FTEs. As stated previously, this process caused a domino effect through the Agency and certain non-SDB FTEs were displaced.

8th floor of the Washington Design Center Build-Out Costs

The OIG stated that nine percent of the newly acquired office space on the 8th floor was "designed for the HUBZone program." This statement is inaccurate and misleading. SBA's Office of Administrative Services (OAS) was tasked with creating the most efficient and inexpensive use of space to adequately house all the FTEs involved in SDB certifications. It should be understood that every decision made by the SBA in regard to allocating space for SDB FTEs had a "rippling effect" on other parts of the Agency. OAS was responsible not only for making sure there was sufficient space for the SDB FTEs, but also for finding space for the segment of the Agency displaced as a result of the insertion of SDB personnel into the mix.

The blueprint the OIG referenced evidences the domino effect created by the SDB certification program. As mentioned earlier, OAS was given limited time to find

adequate space for SDB and non-SDB FTEs. The 8th floor space in the WDC was available and offered to the Agency as rental space. SBA accepted the entire space, anticipating the SDB program would require the whole area since it needed to accommodate 122 approved SDB FTEs. SBA built 90 stations in the WDC, specifically for the use of SDB FTEs. SBA would have accepted more space in the WDC had it been available, to accommodate all of the approved 122 SDB FTEs. However, there was no other space available in the WDC. It was therefore apparent that to house all of the SDB FTEs in the WDC and WOC, it was necessary for SBA to displace some SBA employees and relocate them to other areas of the building.

In the planning phase, HUBZone employees were plotted on a preliminary blueprint in the WDC office space. However, this blueprint was ultimately not used. HUBZone employees never occupied any part of the WDC space. In fact, the Agency has used another and later blueprint which shows HUBZone employees on the 8th floor of the Washington Office Center, and is in fact the actual location of these HUBZone employees. (All blueprints were available to the OIG.) Thus, the fact that a preliminary blueprint housed HUBZone staff in WDC does not show that the space was "designed for HUBZones." If anything, this fact only evidences the Agency's ability to remain flexible when tasked with such a difficult space issue.

The IG pointed out that the Division of Program Certification and Eligibility (DPCE) eventually used this space within the 8(a) program. As stated previously, SBA was required to create the most efficient and cost effective means to house the 122 FTEs approved to work on the SDB certification process. At the design stage of this process, SBA fully anticipated tens of thousands of SDB applications. Reasonable projections and good faith estimates approved by the Working Group supported this belief.

The Agency built out the WDC with the reasonable belief that the program would rapidly expand, a theory consistent with the number of projected applications. SBA had the duty and responsibility to accommodate the anticipated rapid growth of the program. From a construction standpoint, it is much easier to accommodate growth sooner rather than later. In light of the difficulty of finding adequate workspace, it was better to provide for later growth at the onset of the program implementation rather than risk cost of relocation later. SBA also reasoned that it was far more cost efficient to build enough space at the beginning rather than to build space on a piecemeal basis. This decision was particularly prudent in view of OMB's decision that the participating agencies should contribute more at the start of the program to cover start-up costs (such as constructing appropriate work space) than in the subsequent years of the program.

The current location of the 8(a)DPCE group in the WDC does not indicate that this space was constructed for their benefit. As indicated, the build-out of the WDC space was anticipated to benefit the SDB Program alone. SBA made an assessment of the workspace required to serve the SDB certification process and made reasonable accommodations based on this assessment. After construction was completed, portions of the WDC remained vacant as the Agency steadily hired SDB FTEs. SBA chose to keep this area vacant for a short period of time, due to the anticipation that additional staff

would be needed. The 8(a) DPCE's relocation into the WDC space is consistent with GSA guidelines requiring SBA to use excess space and equipment internally or offer it to other agencies. (Moreover, all 8(a) firms are necessarily SDBs.) It was impossible for the Agency to foresee that the actual number of SDB applications would fall far below the projected numbers. At the time the relevant decisions were made, SBA reasonably anticipated that the construction, demolition and design of this space would benefit the SDB certification program. Thus, SBA was justified in allocating 100 percent of these costs to SDB appropriated funds at the outset, despite subsequent events.

It is important here to note that SBA did not simply sit and wait for certification business, once initial decisions had been made. It aggressively pursued a variety of outreach and marketing efforts, continuing to believe original estimates could be realized as word of the program spread. Since the SDB certification program began, SBA has held 30 National Outreach sessions and has 9 more scheduled for this fiscal year.

OGC Office Suite on the 5th Floor of the Washington Office Center

The OIG stated that twenty-two percent of the space in the fifth floor office suite was not allocable to the SDB certification appropriation. We disagree with this assertion. The OIG insisted that because the SDB budget approved only twenty-four Office of General Counsel (OGC) FTEs, eight of the 32 offices and cubicles built in this suite were not allocable to the SDB appropriation. Under the OIG rationale the computer training room and the Women's Business Council occupied the space necessary to build these eight offices.

In so stating, the OIG doesn't fully consider the following. In light of the limited available space in the WDC to house SDB FTEs, SBA was required to build out a space to house the 24 approved FTEs in the Office of General Counsel. But for the SDB program, the design, demolition and construction of the fifth floor office suite was not required. SBA had adequate space on the seventh floor to house all of its non-SDB attorneys. To maintain some semblance of order, control and management, SBA was required to find adequate space for all the SDB attorneys in a contiguous location. The fifth floor was the only available location in the building to do this. Moreover, the SDB attorneys are part of the Office of General Counsel's Office of General Law (OGL). SBA reasonably determined that the Office of General Law needed to be housed together as one unit.

By design, and to accommodate all of OGL, the offices and cubicles in the fifth floor office suite were built to specifications that were less than GSA's size guidelines for office space. As stated previously, SBA researched the most efficient and most cost-effective method to house all the SDB FTEs. SBA determined that by moving its employees into spaces that were smaller than suggested by GSA, the Agency would be able to house its OGL in one centralized area. SBA's alternative to the current layout was to build out the same amount of space on the fifth floor solely for the 24 approved SDB funded FTEs. These 24 offices could have been substantially larger, meeting GSA

guidelines for office space, and would still have displaced the Women's Business Council and computer training room.

In addition to the desire to keep OGL intact, it is also a fact that had all 122 FTEs been hired as originally planned, all of the build-out space in the WDC and on the 5th floor would have been needed for SDB staff and operations.

Government Contracting & Minority Enterprise Development (GC& MED) Offices on the 8th Floor of the WOC and the 2nd Floor WOC Construction

The OIG claims that the newly acquired space on the 2nd floor, designed to replace the 5th floor computer training room, the 5th floor Women's Business Council and the planned conversion of the 8th floor Eisenhower conference room, should not have been allocated to the SDB funds because this space was not required for SDB certification purposes. As previously discussed, but for the SDB program, the Women's Business Council and the 5th floor computer training room would not have been displaced. These offices were moved to accommodate the OGL's move to the fifth floor space. As stated above, the OGL, in its entirety, was moved to the fifth floor as a result of prudent and reasonable management decisions to maintain the integrity of the OGL. The planned conversion of the Eisenhower Conference Room never took place, and the funds for this expense were de-obligated.

Equipment

We have not yet completed our analysis of the OIG's findings that equipment was improperly purchased using SDB funds. Therefore, we have decided to defer our response to these findings until the final report is issued. (For purposes of this response, desk chairs will be considered equipment.)

Compensation and Benefits

The OIG found that compensation and benefits paid to two employees were either wholly or partially ineligible for reimbursement from SDB funds. We agree with the OIG with regard to the two employees and have already reallocated the salary and benefits of those employee to SBA appropriations.

Consulting, Training, and Marketing

We have not yet completed our analysis of the OIG's findings with regard to consulting, training, and marketing and, therefore, have decided to defer our response to these findings until the final report is issued.

Recommendations

The OIG made four specific recommendations as a result of its findings with regard to consulting, training and marketing cost allocations. First, it recommended that the Chief

Financial Officer adjust the SDB certification charges to other agencies after determining the actual FY '98 and FY '99 certification costs, factoring in unallocable expenditures and developing and implementing allocation methodologies. The OCFO is currently in the process of evaluating all expenditures for the SDB program, including expenses paid from SBA appropriations. A key component of that effort is the evaluation of the activity-based cost allocation study for FY '99 that found that the costs of operating the SDB certification program are present both within the direct SDB expenditure account as well as within the general account of SBA, or Salaries and Expenses. SBA believes this method of identifying and allocating costs is appropriate, and the OIG has concluded in our recent meeting that this method is appropriate. As such, we have also begun the start of our next study to update the data for FY 2000.

The OCFO will use the results of the FY '99 study to determine a reasonable allocation of agency wide costs to the SDB program as both direct and indirect costs of that program. This study also lends support to our indirect charge in FY '98 and will assist in forming our estimated indirect charges for FY '00. Further documentation of the cost allocation study is being completed and the guidelines for the FY '00 study will include more specific instructions, consistent with recommendations made by the OIG. This should more clearly identify those costs associated with the SDB program that are paid from agency funds. The OIG comments in this area have been very helpful in strengthening and improving our cost study as we move forward.

SBA has already established stronger internal controls over all programs, including SDB funding. We have established a stronger internal planning process for this account. In addition, SBA has changed its procedures to create dual control over the SDB funds. In the past, one individual held both the authority to commit SDB funds and budgetary responsibility to monitor execution within the account. Under the new procedures, the ADA/GC&MED and Deputy ADA/GC&MED hold authority to commit SDB funds. However, the CFO's Office of Planning and Budget now reviews all obligations. That office is responsible for determining both the availability of funds and the appropriateness of the commitment.

The OIG's second recommendation was that the CFO de-obligate the unexpended balances remaining for ineligible obligations. To the extent necessary and appropriate, the CFO will de-obligate funds once it completes its analysis of these costs.

The third recommendation was that SBA develop and implement guidelines detailing when SDB funds can be used. This will be executed through the internal controls that will be exercised over the expenditure of funds allocated to the program office and more specific guidelines on the allocation of costs when more than one program benefits from the expenditure. Additional guidance is being developed for the conduct of the FY '00 cost allocation study to obtain more definitive responses from SBA employees on time devoted to the SDB program.

The OIG's fourth recommendation was that SDB funds not be used for office renovations unrelated to SDB certification. The OIG noted that this recommendation has already

been implemented. SBA has no comment on this recommendation other than to repeat its position, as explained above, that the renovations paid for with SDB funds were related to SDB certification, and therefore there is no action to be corrected in the future.

Finding B: Improper and Unsupported Distribution of Overhead and Electronic Application System Costs to the SDB Certification Program

Overhead Expenses

According to the OIG, the OCFO applied 15 percent and 10 percent of the funds transferred from other agencies to overhead in FY '98 and FY '99, respectively, without determining what expenses constituted overhead or whether these percentages represented the SDB program's proper share of actual SBA overhead costs. As is the case with regard to many Economy Act-funded activities, an estimate was made at the beginning of the year in order to receive the appropriate level of funding to operate the program. Obviously at that time the agency had no specific basis of knowledge as to what the appropriate indirect costs would be for FY '98, as the program was new and SBA had no comparable experiences from which to draw for a project of this size and scope. Similarly, our experiences in FY '98 did not provide adequate information on which to base an estimate for FY '99 because the program was in a start-up phase.

FY '99 is the first year for which we have comprehensive data on which to base a reasonable cost allocation methodology. As stated above, we have already undertaken the cost study for FY '99, and have provided this to the OIG. We are currently reviewing the results of the study, considering the comments provided by the OIG. It is also our position that the 15 and 10 percent figures were not "arbitrary and unsupported." These numbers were derived from SBA's experience dealing with overhead and indirect costs generally and were based on historical percentages of overhead costs for SBA's other programs. As stated above, SBA is reexamining all charges to the SDB account for FY '98 and '99, including the results of the cost study, to determine the appropriate charges to the SDB funds for these years and to support an estimate of FY '00 indirect charges.

Electronic 8(a)/SDB Application System

We have not yet completed our analysis of the OIG's findings with regard to electronic 8(a)/SDB systems and, therefore, have decided to defer our response to these findings until the final report is issued.

Recommendations

The first OIG recommendation was that the Chief Financial Officer coordinate with the ADA/GC&MED to develop and implement a methodology to allocate overhead for the SDB certification program that meets the requirements of the Economy Act. As stated above, we are currently in the process of doing this.

The second recommendation was that SBA develop and implement a methodology that reasonably allocates the cost of the electronic application system between the 8(a) and SDB certification programs. As stated above, SBA is in the process of analyzing these prior costs and will develop a methodology of allocating future costs of 8(a) and SDB systems.

The OIG's third recommendation was that funds be reallocated as a result of implementing the above recommendations. We accept this recommendation to the extent that we ultimately find that funds need to be reallocated.

Finding C: Other Areas Requiring Management Action to Improve Operation of the SDB Certification Program

SBA Needs to Take Action to be Assured of Continued Funding for SDB Certification

The OIG pointed out in its audit report that there is no law or executive order that requires other federal agencies to reimburse SBA. Therefore, according to the OIG, these federal agencies do not have to reimburse SBA. The OIG opined that this arrangement may not support the SDB certification program in the future. The report did not include specific recommendations for acquiring the appropriate legal authority.

We have considered the OIG's recommendation, and, based on discussions with the Office of General Counsel, have concluded that the Economy Act provides sufficient legal authority to enable SBA to receive funds from the contributing agencies and to operate the program, and, thus, additional legal authority is not considered essential.

SDB Certification Program and Supporting Offices were Overstaffed

According to the OIG, while the actual number of SDB applications was 11 percent of the amount originally estimated, SBA did not adequately adjust the SDB Certification and Eligibility workforce to parallel this reduced workload. The OIG also found that some SDB-funded employees in other SBA offices were not spending 100 percent of their time on SDB functions. The OIG stated that, on average, the SDB-funded attorneys in OGC who were 100 percent funded by SDB estimated they spent 65 percent of their time working on SDB related issues.

Although we do not dispute this finding, we think it is equally important to note that numerous employees not paid directly from SDB funds spent considerable amounts of time in FY '99 on SDB activities. Those employees include the General Counsel, Deputy General Counsel, Human Resources management employees, field employees, staff of the ADA/GC&MED, and staff and managers in the CFO's office.

The OIG also stated in the audit report that, although SBA received far fewer SDB applications than anticipated during its first year; and the monthly numbers did not indicate a significant upward trend, SBA had not adequately reduced the SDB

Certification and Eligibility office's workforce to compensate for this diminished workload.

We strenuously disagree with this finding. The OIG did not consider the fact that the requirements that subcontractors be certified did not become effective until October 1, 1999. SBA did not know what the rate of applications would ultimately be until after that requirement took effect. Many SDBs are more interested in federal subcontracts than prime contracts. As long as SDB subcontractors were able to self-certify as SDBs, they had no incentive to seek certification from the SBA. SBA anticipated a major increase in applications once the subcontracting certification requirement became effective. Therefore, it was not prudent to reduce staffing until this key date had passed and the agency had time to gauge the response to this new requirement. When the anticipated increase did not take place, the SDB office immediately began to reduce its staff and will continue to do so based on workload. As of this writing, SBA has reduced the SDB-funded personnel from 83 to 56, a 33 percent decrease.

SDB Furniture and Equipment was not Inventoried

According to the OIG, the SDB Certification and Eligibility Office management did not inventory its furniture and equipment in the Fixed Asset Accountability System (FAAS), an Agency-wide inventory system for managing property. As a result, SDB officials did not know where some furniture and equipment were located.

We agree with the OIG that certain items of inventory were not properly inventoried. We are currently taking action to correctly inventory all items in accordance with FAAS. We have also taken action to insure that all future equipment purchased for the SDB office will be inventoried in accordance with SBA's Standard Operating Procedures.

SDB Certification Program Purchased Excess Equipment

The OIG determined that the SDB Certification and Eligibility office purchased excess SDB equipment that remained in storage for over one year, and pointed out that SOP-00-13-4 requires the disposal of excess property by finding other offices within SBA or other agencies that can use the property.

We disagree with the OIG's finding that equipment remained too long in storage and should have been declared excess and given away or otherwise disposed of. At the time the SDB certification program was established, it was anticipated that SBA would receive at least 30,000 applications. The SBA expected a significant increase in applications once the requirement that federal subcontractors be certified by SBA became effective. That did not occur until October 1, 1999.

In addition, the SBA did not know when and if the results of its intensive marketing efforts would be realized in the form of an increase in applications. Up until very recently, the lack of application submissions was believed also to be the result of a lack of awareness on the part of the public. Most sources in and outside of SBA believed that

applications would increase significantly once the public was made fully aware of the certification requirement and the implications of not being SBA-certified. For these reasons, it was only prudent management not to dispose of any potential excess equipment until it was clear that applications would not significantly increase and that additional staff would not be hired. Thus, it was not unreasonable under the circumstances to hold the relevant items of equipment for over one year.

Recommendations

The OIG's first recommendation was to seek legal authority to require reimbursement from other agencies. As stated above, we do not believe this is necessary.

The OIG's second recommendation was to assess future SDB workload requirements with appropriate offices employing SDB-funded employees and to adjust staffing levels accordingly. This has already been done, and will continue to be done as the program matures.

The OIG's third recommendation was to ensure that SDB equipment valued over \$50 is inventoried through the FAAS. This is also being accomplished.

The OIG's fourth and final recommendation was that we should dispose of any excess equipment in accordance with GSA guidelines. We are currently in the process of doing this.

Thank you for the opportunity to comment on this draft report. We will continue to work with your staff as we further analyze the various items of cost in anticipation of a more complete response to the final audit report.

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

DATE: June 21, 2000

TO: Robert G. Seabrooks
Assistant Inspector General for Auditing

FROM: James C. Ballentine, ADA/GC/MED *J.C. Ballentine*
Joseph P. Loddo, CFO *Joe Loddo*

SUBJECT: Audit of SDB Certification Program Obligations and Expenditures

This memorandum is provided to give you a more current and complete response to the remaining issues identified in your DRAFT audit report, since several of the items were still being reviewed and analyzed by our staffs at the time the May 12 response was submitted to you. We ask that the entire content of this memorandum be incorporated into our previous May 12th response to you. With these efforts, we believe that all substantive issues identified in the audit have been satisfactorily addressed. We will work closely with your office to implement these recommendations.

Overview:

The SDB initiative was established in collaboration with OMB, DOJ, and other Federal Agencies as a response to the Supreme Court's Adarand v Pena decision. As we have previously noted, this initiative incorporates elements of three statutes: section 1207 of the National Defense Authorization Act for Fiscal Year 1987, Pub. L. 99-661; the 1994 Federal Acquisition Streamlining Act (FASA); and the Small Business Act. Further, the Economy Act authorizes SBA to act as a service provider and charge other agencies for SDB certification and related services.

The SDB certification program encompasses more than just SDB certification. It centralizes the government-wide certification process for small disadvantaged businesses within SBA, providing a number of contract benefits for SDBs, and includes outreach and training.

Updated Response:

We understand from the meeting with your staff on Wednesday, June 7, 2000, that you have revised your questioned costs downward by about \$500 thousand based on the additional discussion between our offices. Additionally, from your meeting with the OCFO on Thursday, June 8, 2000, we understand that you have accepted the FY 1999 cost allocation study, as adjusted, to justify the indirect costs for FY 1998 and FY 1999. We are very pleased with the progress that we have been able to jointly make during this time to reach a consensus on the financial management issues that were identified in the DRAFT report.

The costs that have been questioned by your office now total \$2.967 million. You identified \$868 thousand of these costs as never having been liquidated, leaving a "net" obligation of \$2.099 million that needs to be reversed and charged to SBA's Salaries and Expenses account in FY 1998 and FY 1999. We concur with most of these questioned costs, with only minor differences. We believe the differences represent timing adjustments since you first started your review effort.

Our total for the agreed-upon questioned items is \$2.959 million. We need to separately identify FY 1998 and FY 1999 charges and adjustments due to the use of specific annual appropriations. Therefore, our analysis results in the following: \$2.515 million in questioned costs in FY 1998, less \$553 thousand in unliquidated obligations, for a "net" obligation adjustment to SBA's Salaries & Expenses of \$1.962 million. The revised FY 1998 total obligations is therefore \$7.419 million, leaving a balance of \$3.842 million.

For FY 1999, we have identified \$443 thousand in questioned costs, less \$99 thousand in unliquidated obligations, for a "net" obligation adjustment to SBA's Salaries & Expenses of \$344 thousand. The revised FY 1999 total obligations, before the adjustment in indirect costs explained below, is \$9.077 million.

The cost allocation study identifies a total cost of SDB certification and related services for FY 1999 of \$11.298 million. Further adjustments to the study of \$154 thousand have been identified and accepted by our office, and, when added to the \$443 thousand in questioned costs above, result in total obligations for the SDB program for FY 1999 of \$10.701 million, leaving a balance of \$302 thousand.

The above adjustments to charge the additional indirect costs to FY 1999 and to reverse the questioned costs are currently being made in our accounting system. Additionally, we intend to rebate to the reimbursing agencies \$3.551 million in FY 1998 funds and \$266 thousand in FY 1999 funds. These rebates may end up slightly different due to additional time lapsed between this analysis and the final accounting adjustments. The accounting adjustments will be completed this month and the rebates soon thereafter.

In addition to the above, we have analyzed the indirect charges in FY's 1998 and 1999, using the FY 1999 cost allocation study as a basis. The FY 1998 indirect costs of \$1.689 million represent 29 percent of the adjusted direct obligations. The FY 1999 indirect costs of \$2.694 million from the study represent 34 percent of the adjusted direct obligations for FY 1999. While SBA did not have available a detailed cost study to fully justify the indirect cost allocation used in FY 1998, the results of the FY 1999 cost allocation study sufficiently support these charges as reasonable and justifiable, and we understand that you concur with this conclusion. It is also reasonable to use this same study as the initial basis for determining the FY 2000 indirect costs that will be validated through the FY 2000 study to be undertaken later this year.

We have attached a summary of the recommendations in your DRAFT report and our current response to each. This review has been helpful to our financial management of the SDB program, and as a result we are confident that only obligations that directly relate to the SDB program are now charged against SDB funding.

If you have any questions about these issues, or need further clarification, please call us.

Summary of OIG SDB Audit Recommendations

- A01. Instruct the Chief Financial Officer to adjust the SDB certification charges to other agencies after determining the actual FY's 98 and 99 SDB certification costs, factoring in the unallocable expenditures (see Appendix A) and developing and implementing allocation methodologies (see recommendation B03). If the amount collected exceeds the actual cost, the CFO should be instructed to return the excess collected to the other agencies. If the actual cost exceeds the amount collected, the CFO should be instructed to collect the additional funds from these agencies.

We agree, and are in the process of making the appropriate accounting adjustments during the month of June, followed by rebates to the agencies.

- A02. Instruct the Chief Financial Officer to de-obligate all unexpended balances remaining for ineligible obligations (see Appendix A).

We agree, and as part of our accounting adjustments these de-obligations are being made.

- A03. Develop and implement guidelines detailing when SDB funds can be used.

We agree to develop an annual operating budget plan that contains sufficient details on expenditures to allow a determination as to the appropriateness of the use of funds in accordance with the Economy Act agreements. The plan would be submitted through the CFO to the Deputy Administrator for approval.

- A04. Not use SDB funds for office renovations not related to SDB certification. This recommendation has already been implemented.

We agree, and have already implemented as noted.

- B01. We recommend that the Chief Financial Officer coordinate with the Associate Deputy Administrator/Government Contracting & Minority Enterprise Development to identify all direct and indirect costs chargeable to the SDB fund, and develop and implement an allocation methodology to allocate overhead for the SDB Certification program that meets the requirements of the Economy Act.

We agree, and have completed the FY 1999 cost allocation study that provides the methodology and allocation of direct and indirect costs to the SDB certification program. This will be further refined for FY 2000. It will serve as the basis for allocations in the budget plan for future years, and will serve to validate these charges after the year has concluded.

- B02. We recommend that the Associate Deputy Administrator/Government Contracting & Minority Enterprise Development coordinate with the Chief Information Officer to develop and implement an allocation methodology that reasonably allocates the cost of the electronic 8(a)/SDB application system between the 8(a) and SDB Certification programs.

We agree, and are currently in the process of devising a cost allocation method to allocate the costs of the 8(a)/SDB electronic application between the 8(a) and SDB programs. We hope to devise a strategy that will fairly allocate these costs, factoring in SBA employee salaries, relative costs for the total application, and portions of the application that apply only to the 8(a) program and should not be charged at all to SDB funds. We look forward to working with your office in this effort.

- B03. We recommend that the Associate Deputy Administrator/Government Contracting & Minority Enterprise Development direct the Chief Financial Officer, based on the results reached from implementing recommendations B01 and B02, adjust the charges to SDB for the FY 1998 and FY 1999 overhead and the 8(a)/SDB application system.

We agree, and the current accounting adjustments will incorporate these items.

- C01. We recommend that the agency seek legal authority to require reimbursement from the other agencies to fund the SDB certification program through an Executive Order or amendments to the Federal Acquisition Regulations.

The Economy Act provides sufficient legal authority for us to administer the SDB program and bill the participating agencies. This authority is the same as used by all agencies operating similar activities, and they would experience the same problems.

- C02. Assess future SDB workload requirements with appropriate offices employing SDB-funded employees and adjust staffing levels accordingly.

We agree, and have already made program adjustments in FY 2000 reducing the staffing level from about 80 to 50. We continue to assess the anticipated workload and will factor this into our FY 2001 planning.

- C03. Ensure that all SDB equipment valued over \$50 is inventoried through the FAAS.

We agree, and are currently undertaking a detailed inventory of furniture and equipment that should be completed this summer.

- C04. Assess whether any SBA offices can use some or all of the excess SDB equipment and, if so, sell them the equipment. If a need cannot be identified, notify GSA to make the equipment available to others.

We agree that if excess SDB-funded equipment can be used elsewhere within the Agency, we will follow appropriate rules to transfer this equipment. Excess equipment not elsewhere needed will be disposed of in accordance with applicable regulations.

FURTHER EVALUATION OF MANAGEMENT'S RESPONSE

Comment 1. Management stated that the draft report did not include any of their explanations or reasons given for charging various items to the SDB funds and that the report did not describe the conditions under which their decisions were made. Management construed absence of their explanations and the conditions as creating a strong impression of wrongdoing or bad faith. Management objected to the perceived inference that there was bad faith involved in SBA's decisions to allocate costs to the SDB program under the Economy Act. Management stated that all parties concerned believed that SBA would receive considerably more certification applications, requiring a much larger staff, larger facilities, and more equipment than has so far proved to be the case. Management firmly believes that all decisions have been made in good faith and that all funding allocations were justified, legal and appropriate.

OIG Evaluation 1. The draft report did not state or imply that there was wrongdoing or bad faith. It identified those expenditures where SDB funds were used but should not have been. When Management provided an adequate explanation during the audit process justifying the costs, we accepted their explanation. However, if Management provided no feedback or the explanation was not convincing, we questioned the item in the report. Where appropriate, we have included explanations from Management's responses to the draft report in the final report.

Comment 2. Management stated that the draft report was inaccurate and misleading by reporting that a portion of the office space in the WDC was designed for the HUBZone program. They claimed that the auditors were looking at preliminary plans, which plotted HUBZone in the WDC blueprints, and that this plan was ultimately not used.

OIG Evaluation 2. We stated that nine percent of the office space in the WDC was designed for the HUBZone program because we were told by Administrative Services that there was no other blueprint for the WDC that excluded HUBZone on the plan. The blueprint Management referred to as "preliminary" was dated 8/2/98, and construction was to start soon thereafter on 8/24/98, so it did not appear that this was merely a preliminary blueprint. We also had the following additional evidence to conclude that SBA designed part of the 8th floor of the WDC for the new HUBZone Program:

- Furniture layout plans for that area, dated 8/10/98, also indicated "HUBZone";
- A 9/2/98 opinion signed by the Designated Agency Ethics Officer within the Office of General Counsel concerning a company involved in designing and constructing the space in question referred to this area as "new space for the SDB and HUBZone programs at the Headquarters building";
- The punch list that SBA completed after completion of the WDC construction referenced the HUBZone offices;

- A HUBZone employee informed us as late as July-August 1999 (several months after construction was completed) she packed her office because she was getting ready to move to the WDC.

Despite this evidence that some of the SDB funds were used to build HUBZone space, we dropped the questioned costs relating to HUBZone based on the rationale that the Agency built space for 122 employees.

Comment 3. Management stated that the 8(a) Division of Program Certification and Eligibility's (DPCE) current location in the WDC does not indicate that this space was constructed for their benefit.

OIG Evaluation 3. The draft report did not state or allude that the space in the WDC was constructed for the benefit of 8(a) DPCE. The actual wording in the draft report was "Nine percent of the newly acquired office space on the 8th floor was designed for the HUBZone program and eventually used by the Division of Program Certification and Eligibility within the 8(a) Program." The purpose of that statement was to show that 9% of the space was neither designed for nor occupied by SDB funded employees.

Comment 4. Management stated that "all 8(a) firms are necessarily SDBs."

OIG Evaluation 4. During the audit, SBA officials presented the argument that since all 8(a) companies were SDBs, SDB funds could be used for 8(a) purposes. While 8(a) firms are necessarily SDBs, that does not mean that SDB funds should pay for costs that have been historically paid for with 8(a) funds and that are for the use of the 8(a) Program, e.g. 8(a) certification costs. The 8(a) program already receives funding through the SBA budget, and the SDB certification funds should not be used to augment the 8(a) budget.

Comment 5. Management stated that the SDB Certification program, in addition to certification, provides contract benefits for SDBs, and includes outreach and training.

OIG Evaluation 5. SBA's SDB Certification program (versus the government-wide SDB program), responsibilities are limited to those listed in the Federal Register dated June 30, 1998, page 35771: (1) certifying SDBs, (2) resolving protests regarding SDB status, (3) overseeing a network of private certifiers, and (4) maintaining a database of certified SDBs. As such, it does not include providing contract benefits to SDBs, and SDB funding for outreach and training should be limited to the SDB certification process.

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AUDITING DIVISION

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E

**AUDIT OF MINORITY BUSINESS ENTERPRISE
LEGAL DEFENSE AND EDUCATION FUND, INC.
COSPONSORSHIP EXPENSES AND INCOME**

AUDIT REPORT NUMBER 0-29

SEPTEMBER 29, 2000

**This report may contain proprietary information subject to the provisions of
18 USC 1905 and must not be released to the public or another agency without permission
of the Office of Inspector General.**



U.S. Small Business Administration
Office of Inspector General
Washington, DC 20416

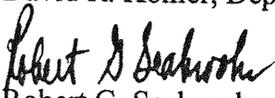
AUDIT REPORT

Issue Date: September 29, 2000

Number: 0-29

TO: Kerry L. Kirkland, Associate Deputy Administrator for
Government Contracting & Minority Enterprise Development

David R. Kohler, Deputy General Counsel

FROM: 
Robert G. Seabrooks, Assistant Inspector General
for Auditing

SUBJECT: Audit of Minority Business Enterprise Legal Defense and Education Fund, Inc.
(MBELDEF) Cosponsorship Expenses and Income

We completed an audit of the MBELDEF cosponsorship expenses and income under Cosponsorship Agreement Authorization No. 98-6360-71. The agreement provided that SBA and MBELDEF, which is located in Washington, DC, would cosponsor training regarding new 8(a), HUBZone, and Small Disadvantaged Business (SDB) rules and contracting procedures. The agreement further provided for training to take place at 12 major cities from October 1998 through April 1999. As SBA's cosponsor, MBELDEF was responsible for general administration as well as executing and overseeing various contracts for the training events, e.g., curriculum development, marketing, printing of workshop material, workshop logistics, and on-site services.

The estimated cost of the cosponsorship was \$1,337,800. The approved budget called for Federal funding of \$900,000, income from attendee fees of \$308,335, and an in-kind contribution from MBELDEF of \$129,465. MBELDEF had received \$646,611 in Federal funding when the cosponsored activity was completed. MBELDEF also reported that it received \$81,545 from attendee fees, but did not provide the records necessary to determine whether it properly accounted for these fees. MBELDEF did not provide any support for in-kind contributions.

AUDIT OBJECTIVES AND SCOPE

The audit objectives were to determine whether the payments made to MBELDEF for services related to the cosponsorship were justified, to determine MBELDEF's compliance with the terms of the cosponsorship agreement, and determine whether MBELDEF properly accounted for the fee income it collected. The agreement required MBELDEF to submit

invoices to justify expenditures. We considered an expense to be unjustified if it had no accompanying invoice, it had already been paid, it was unrelated to the cosponsorship activity, or it was never actually incurred. MBELDEF did not provide the records necessary to determine the extent of their non-compliance with the in-kind contribution and whether MBELDEF properly accounted for the fee income it collected. We reviewed the Cosponsorship Agreement, documents supporting MBELDEF's requests for payment and SBA's approval of MBELDEF's invoices, and other documents related to the cosponsorship. We interviewed MBELDEF's President, MBELDEF's accountant, and SBA officials.

We reviewed MBELDEF's activities for the period August 1998 through May 1999. Fieldwork was conducted from May 22, 2000 to September 15, 2000. The audit was conducted in accordance with Government Auditing Standards.

RESULTS OF AUDIT

MBELDEF was paid \$121,394 for unjustified expenses under the cosponsorship. Also, MBELDEF did not provide the amount of in-kind contribution agreed upon in the agreement, and did not provide the auditors with documentation supporting the accuracy of the \$81,545 that it reported as fees collected. At a meeting, SBA management officials agreed to seek reimbursement from MBELDEF for the unjustified expenses with the condition that SBA first is allowed to obtain a final accounting from MBELDEF. They also stated that they had insufficient time to provide a full response.

In response to the audit, MBELDEF stated that it had appropriate documentation for all expenses incurred and fees collected. They also requested an additional seven days to provide the supporting documentation and reconsideration of the recommendation related to its in-kind contribution. Any additional documentation provided by MBELDEF will be evaluated as part of the audit resolution process. MBELDEF's response in its entirety is included as Attachment 1.

Finding 1: Unjustified Cosponsorship Expenses

MBELDEF submitted claims and was paid \$121,394 for expenses under the cosponsorship that were not justified. SBA paid MBELDEF \$112,316 for expenses without supporting invoices, \$3,807 for duplicate expenses, \$3,640 for expenses unrelated to the cosponsorship activity, and \$1,631 for expenses claimed that were not incurred. Under the terms of the cosponsorship agreement, MBELDEF was required to submit invoices to justify expenditures.

Unsupported Expenses

MBELDEF did not submit invoices for \$112,316 of the \$728,156 it received under the cosponsorship. One claimed expense, \$77,584 for contract administration, accounted for 69 percent of the amount claimed without invoices. Cancelled checks totaling \$22,566 were submitted in lieu of invoices. Submitting cancelled checks without accompanying invoices neither met the terms of the agreement nor did it permit SBA to determine whether the expenses were related to the cosponsorship agreement.

Duplicate Expenses

MBELDEF submitted duplicate invoices and was overpaid \$3,807. The duplications included payments to contractors, MBELDEF's accountant, a travel agency and a printing company. In addition, MBELDEF included \$491 in payments for meals delivered to the hotel room to individuals who also received per diem payments for the meals.

Expenses Unrelated to Cosponsorship

SBA paid MBELDEF \$3,640 for expenses unrelated to the agreement. The unrelated expenses included an MBELDEF employee's personal expenses, work done for MBELDEF prior to the cosponsorship agreement being signed, and charges for 2 of 3 hotel rooms assigned to the same individual for the same time.

Expenses That Were Not Incurred

SBA paid MBELDEF \$1,631 for expenses that MBELDEF did not incur. While MBELDEF did not incur expenses for cancelled airline flights, it submitted invoices for them to SBA.

RECOMMENDATION

- 1A. We recommend that the Associate Deputy Administrator for Government Contracting & Minority Enterprise Development require MBELDEF to reimburse SBA \$112,316 for unsupported expenses, \$3,807 for duplicate payments, \$3,640 for unrelated expenses, and \$1,631 for claimed expenses that were not incurred.

SBA Management's Response

SBA management agreed with the recommendation, with the condition that SBA first endeavor to obtain a final accounting from MBELDEF, and that the recommendation may be implemented by a senior official other than the Associate Deputy Administrator for Government Contracting & Minority Enterprise Development.

OIG Evaluation of Management's Response

The comments provided by SBA management are responsive to our recommendation.

Finding 2: Other Matters

MBELDEF Did Not Provide the Amount of In-kind Contribution Agreed Upon

MBELDEF's President acknowledged that MBELDEF did not provide all of the in-kind contribution that it agreed to in the cosponsorship. The in-kind contribution consisted of non-Federally funded time spent by MBELDEF employees on the agreement. MBELDEF's President informed SBA that MBELDEF could not meet the in-kind requirement five days after signing the cosponsorship agreement in a September 30, 1998 letter to the Acting Associate Administrator for Small Disadvantaged Business Certification & Eligibility (AA/SDB) and the Associate Administrator for Business Initiatives. Though the President of MBELDEF requested a modification to the cosponsorship agreement, SBA did not modify the agreement. Also, the Acting AA/SDB stated that the Associate Deputy Administrator for Government Contracting & Minority Enterprise Development told her not to worry about MBELDEF's letter and as a result, SBA did not formally respond to MBELDEF. According to the cosponsorship agreement, an amendment to the agreement must be in writing and agreed to by both MBELDEF and SBA. While the cosponsorship agreement provided that MBELDEF would make an in-kind contribution, the agreement neither required MBELDEF to account for the time nor included any consequences for MBELDEF's non-compliance.

MBELDEF Did Not Provide Auditors with Documentation Supporting the Accuracy of Amounts Reported as Fees Collected

As of the end of fieldwork on this audit, MBELDEF had not provided the auditors with the documentation necessary to determine the accuracy of the \$81,545 that it reported as attendee fees. The agreement required MBELDEF to spend these fees ahead of other funding sources. Until these fees can be properly accounted for, SBA cannot determine whether it spent the proper amount under the agreement.

RECOMMENDATIONS

We recommend that the:

- 2A. Deputy General Counsel determine what action can be taken against MBELDEF for non-compliance with the cosponsorship agreement terms regarding the shortfall of MBELDEF's in-kind contribution.
- 2B. Associate Deputy Administrator for Government Contracting & Minority Enterprise Development implement the action the General Counsel determines is appropriate in recommendation 2A.
- 2C. Associate Deputy Administrator for Government Contracting & Minority Enterprise Development require MBELDEF to provide a full accounting of the attendee fees collected.

- 2D. Associate Deputy Administrator for Government Contracting & Minority Enterprise Development require MBELDEF to pay SBA any fees obtained in excess of the \$81,545 reported, if the full accounting required in recommendation 2C shows that not all fees were reported.

SBA Management's Response

SBA management agreed with the four recommendations, with the condition that a senior official other than the Associate Deputy Administrator for Government Contracting & Minority Enterprise Development may implement recommendations 2B, 2C, and 2D. SBA management stated that once it has completed its review, SBA will consider its legal rights under the cosponsorship agreement and that it would coordinate with the OIG in an effort to pursue the matter regarding MBELDEF's accountability for fees collected.

OIG Evaluation of Management's Response

The comments provided by SBA management are responsive to our recommendations.

* * * * *

The findings and recommendations in this audit report are based on the conclusions of the OIG's Auditing Division. The recommendations are subject to review, management decision and corrective action by your office in accordance with existing Agency procedures for audit follow-up and resolution.

Please provide your management decision for each recommendation within 80 days. Your management decisions should be recorded on the attached SBA Forms 1824, Recommendation Action Sheet, and show either your proposed corrective action and target date for completion, or explanation of your disagreement with our recommendations.

Should you or your staff have any questions, please contact Robert Hultberg, Director, Business Development Programs Group at (202) 205-7204.

Attachments

MBELDEF

Minority Business Enterprise Legal Defense and Education Fund, Inc.

Visit our Website "www.mbeldef.org"

Parren J. Mitchell
Founder and Chairman

Anthony W. Robinson
President

September 28, 2000

Mr. Robert G. Seabrooks
Assistant Inspector General for Auditing
U.S. Small Business Administration
Office of Inspector General
Washington, D.C. 20416

Re: Draft Audit Report on Co-Sponsorship Agreement
Authorization No: 98-6360071

Dear Mr. Seabrooks:

This letter is written in response to your draft letter dated September 18, 2000 regarding the co-sponsorship agreement between the Small Business Administration (SBA) and the Minority Business Enterprise Legal Defense and Education Fund, Inc. (MBELDEF).

Please accept our apologies for not having responded by September 27, 2000. As of this date, our bookkeeper for this project has been in the midst of an office move and, therefore, has been unavailable to us. Notwithstanding our belated response, MBELDEF stands prepared to remain cooperative with SBA in resolving these issues.

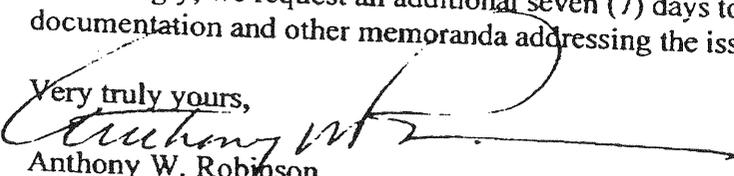
The audit concluded that MBELDEF was paid \$121,394 for unjustified expenses. However, we wish to emphasize that we have appropriate documentation for every expense including invoices and registration forms that support the accuracy of the fees collected and expenses incurred.

In addition, we request, as a matter of equity, that your office reconsider your recommendation relative to the "in kind" contribution. It would be impossible for my small non-profit organization to give that level of a contribution.

Such an "in kind" contribution would bankrupt MBELDEF; surely, this was not the intention of SBA when it executed the co-sponsorship agreement with us.

Accordingly, we request an additional seven (7) days to provide you with the supporting documentation and other memoranda addressing the issue of "in kind" contributions.

Very truly yours,


Anthony W. Robinson
President

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Agency Comments to Audit
Received After Final Audit Report Issued



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

DATE: October 2, 2000

TO: Phyllis K. Fong
Inspector General

FROM: Kerry L. Kirkland *Kerry L. Kirkland*
Associate Deputy Administrator for Government
Contracting and Minority Enterprise Development

David R. Kohler *David R. Kohler*
Deputy General Counsel

SUBJECT: Draft Audit Report, Cosponsorship Agreement,
Authorization No. 98-6360-71

We are responding to the draft audit report referenced above.

This draft report was provided to SBA officials a few days ago. You asked for the Agency's response by September 27, 2000. This period of time was not adequate to respond in detail to the findings made in this draft. We gave you a quick response on that date and we have had some further discussion.

The Agency is normally given at least 30 days by your office to comment on a draft audit report before its issuance in final form, and OMB audit procedures specify at least this period of time when GAO performs an audit and provides a draft. (OMB Circular A-50, par. 8b.) The attached comments reflect our latest views but they are not as complete as they otherwise could be, and therefore we request that your draft document, and any final version you may issue before receiving further comment from us, be treated confidentially. There are a number of important issues touched upon in this document in ways which could reflect adversely upon the Agency, and the Agency believes it may be able to provide additional information.

Attachment:

Comments on Draft Audit Report, Cosponsorship Agreement, Authorization No. 98-6360-71

Comments on Draft Audit Report, Cosponsorship Agreement, Authorization No. 98-6360-71

Finding 1. This finding relates to three categories of unjustified expenses claimed by MBELDEF. With respect to the bulk of these expenses, \$77,584 for "contract administration", our understanding is this sum represents salary expenses for employees hired by MBELDEF to perform its obligations under the cosponsorship. As indicated above, there would not normally be a third-party invoice, although the expense of course should be documented. We will pursue obtaining documentation to support our understanding. On this expense and on the remaining expenses not adequately justified by MBELDEF, we intend to seek reimbursement.

Recommendation 1A. We agree, with the conditions that we first endeavor to obtain a final accounting from MBELDEF, and that the demand may be made by a different senior official.

Finding 2. The finding regarding MBELDEF's position on in-kind contributions contains a complicated but incomplete factual picture. Once management has completed its review, we will consider our legal rights under the cosponsorship agreement, which is a form of contract, although not a procurement contract. It need not specify consequences for non-compliance for SBA to be able to assert breach and pursue legal remedies.

We share your concern regarding accountability for fees collected from attendees. With your coordination, we intend to pursue this matter with MBELDEF.

Recommendation 2A. We agree.

Recommendation 2B. We agree, although the official implementing the legal recommendation may be this individual or some other senior official.

Recommendation 2C. We agree, although another official may be appropriate.

Recommendation 2D. We agree, although another official may be appropriate.

F

**AUDIT OF SBA'S ADMINISTRATION
OF THE MBELDEF COSPONSORSHIP**

AUDIT REPORT NUMBER 0-30

SEPTEMBER 30, 2000

This report may contain proprietary information subject to the provisions of 18 USC 1905 and must not be released to the public or another agency without permission of the Office of Inspector General.

AUDIT OF SBA'S ADMINISTRATION OF THE MBELDEF COSPONSORSHIP

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U.S. Small Business Administration
Office of Inspector General
Washington, DC 20416

AUDIT REPORT
Issue Date: September 30, 2000
Number: 0-30

TO: Kerry L. Kirkland, Associate Deputy Administrator for
Government Contracting & Minority Enterprise Development

John M. Bebris, Acting Associate Administrator for Business Initiatives

David R. Kohler, Deputy General Counsel

Robert G. Seabrook

FROM: Robert G. Seabrooks, Assistant Inspector General
for Auditing

SUBJECT: Audit of SBA's Administration of the MBELDEF Cosponsorship

Attached is a copy of the subject audit report. The report contains five findings with seven recommendations. The findings in this report are the conclusions of the Office of Inspector General's Auditing Division. The findings and recommendations are subject to review and implementation of corrective action in accordance with existing Agency procedures for audit follow-up and resolution.

Please provide your management decision for each recommendation made to you within 30 days from the date of this report using the attached SBA Forms 1824, Recommendation Action Sheet.

Any questions or discussion of the issues contained in the report should be directed to Robert Hultberg, Director, Business Development Programs Group, at (202) 205-7204.

Attachments

SUMMARY

The purpose of this audit was to determine whether SBA properly managed its cosponsorship agreement with MBELDEF for its Small Disadvantaged Business (SDB) program introduction and outreach tour. The SDB program provides procurement benefits to small disadvantaged businesses bidding on Federal contracts by giving them up to a 10 percent price preference on their bids. While the SDB program started out as a self-certification program, SBA began certifying SDBs in 1998. In September 1998, SBA entered into a cosponsorship agreement with the Minority Business Enterprise Legal Defense and Education Fund, Inc. (MBELDEF) to conduct a nationwide tour to explain details of various programs, including the SBA certification process.

We found that SBA did not take appropriate actions both before and after signing the cosponsorship agreement (the cosponsorship), which committed SBA to disburse up to \$900,000 in government funds to MBELDEF. Deficiencies included:

- Entering into the cosponsorship without determining SBA's authority to disburse government funds through cosponsorship agreements;
- Entering into the cosponsorship without ensuring adequate safeguards over the Government's interests;
- Lacking controls to assure appropriated funds were properly spent;
- Failing to raise known significant problems with MBELDEF's handling of the cosponsorship to the appropriate levels; and
- Failing to enforce the terms of the cosponsorship in reviewing MBELDEF claimed expenses.

SBA management officials provided comments to a draft of this report during meetings. They also stated that they had insufficient time to provide a full response. They agreed with five recommendations and generally agreed with two recommendations. A summary of their comments and our analysis are contained at the end of each finding.

INTRODUCTION

A. BACKGROUND

The Small Disadvantaged Business (SDB) program provides Federal procurement benefits to small disadvantaged businesses bidding on Federal contracts by giving them up to 10 percent price preference on their bids. Until 1998, companies self-certified that they were small and disadvantaged prior to bidding on federal contracts. However, after the Supreme Court's decision in *Adarand Constructors, Inc. v. Peña*, 515 U.S. 200 (1995), the Department of Justice (DOJ) evaluated all Federal procurement programs that used race-based criteria. Based on this review, DOJ recommended that small disadvantaged businesses be pre-certified by the government prior to receiving Federal contracts in order to withstand court challenges to the program.

SBA established the Small Disadvantaged Business Certification and Eligibility Office within Government Contracting & Minority Enterprise Development (GC/MED) in 1998 to certify SDBs. Details of the new SBA certification process were explained in a nationwide tour of 2-day training sessions in 13 cities. On September 25, 1998, SBA entered into a cosponsorship agreement (Authorization No. 98-6360-71) with the Minority Business Enterprise Legal Defense and Education Fund, Inc. (MBELDEF) to conduct the nationwide tour. According to Standard Operating Procedure (SOP) 90 75 2 (cosponsorship SOP), a cosponsorship is an activity, event, or initiative that is planned or conducted jointly by SBA and one or more cosponsors, or promoted, publicized, or identified with SBA through use of the SBA Logo or Seal. The Office of Business Initiatives (BI) is responsible for overseeing cosponsorship agreements. A section of the Small Business Act (15 U.S.C. § 637(b)(1)(A)) gives SBA statutory authority to enter into cosponsorships, in conjunction with other entities, for a wide variety of training and counseling programs to assist small business.

MBELDEF was founded in 1980 as a non-profit organization dedicated to addressing issues affecting the class interests of minority business enterprises. It acted as a national, public interest law firm and membership organization.

Under the terms of the cosponsorship agreement, MBELDEF was responsible for general administration as well as executing and overseeing various contracts for the program introduction and outreach tour. Activities included curriculum development, marketing, printing of workshop material, workshop logistics, and on-site services. Under the terms of this agreement, SBA was to pay MBELDEF up to \$900,000 (\$600,000 was to come from a pool of funds SBA received from other Federal agencies for certifying SDBs and the remaining \$300,000 was transferred from the Department of Defense specifically for this cosponsorship). SBA provided MBELDEF an initial advance of \$368,630. According to SBA officials, MBELDEF did not participate in the last 4 conferences, while MBELDEF acknowledged it had no significant role in the last 3 conferences.

B. AUDIT OBJECTIVE AND SCOPE

The audit objective was to determine whether SBA properly managed the cosponsorship agreement with MBELDEF for the SDB program introduction and outreach tour. Our audit covered activities relating to the cosponsorship agreement from August, 1998 through May, 1999. SBA disbursed its last payment to MBELDEF on this cosponsorship on May 25, 1999.

We audited all available invoices for which MBELDEF received payment under the cosponsorship agreement. We reviewed SBA and MBELDEF's records supporting payments made to MBELDEF by SBA, the information SBA used to reimburse MBELDEF, relevant documentation concerning this cosponsorship agreement and other procurement methods, e.g., SBA's Standard Operating Procedures on cosponsorship agreements, the Federal Acquisition Regulation, the Federal Grant and Cooperative Agreement Act, OMB Circulars, and legal opinions concerning cosponsorship agreements. Additionally, we interviewed MBELDEF's President, MBELDEF's accountant and SBA officials in the following offices: Business Initiatives (BI), Government Contracting & Minority Enterprise Development (GC/MED), General Counsel (OGC), and Administration.

MBELDEF did not provide all the requested documents, and SBA did not maintain the necessary documentation for us to determine the total costs expended by SBA for the cosponsorship. Therefore, we were unable to satisfy ourselves with respect to the total amount for these items. We were, however, able to address the audit objectives by identifying problems with the management of the cosponsorship.

The fieldwork was conducted from May 22, 2000 to September 15, 2000. The audit was conducted in accordance with Government Auditing Standards.

RESULTS OF AUDIT

Finding 1: SBA Did Not Determine Its Authority to Disburse Funds to a Cosponsor

SBA disbursed funds through this cosponsorship without determining whether it had the required authority and without incorporating the requirements of Circular A-110, "Uniform Administrative Requirements for Grants and Agreements with Institutions of Higher Education, Hospitals and Other Non-Profit Organizations." Under generally accepted rules of statutory construction, when a law is not clear, deference is given to the implementing agency's interpretation of the law. The statutory language giving SBA the authority to enter into cosponsorships does not include specific language permitting SBA to disburse Federal funds through a cosponsorship. OGC has not issued an opinion on whether SBA has the authority to disburse funds to a non-government cosponsor through a cosponsorship.

The statute, 15 U.S.C. § 637(b)(1)(A) provides that the Administration is empowered to provide technical and managerial aids to small-business concerns. These aids include cooperating with and advising institutions and other Federal and State agencies and any other activities as are deemed appropriate by the Administration. The statutory language on cosponsorships, however, contains no express authorization for SBA to use cosponsorships as a vehicle for spending appropriated funds. According to Senate Report 98-438, which accompanied the Act, cosponsored training is a highly leveraged program, utilizing minimum budget funds from the Agency. Also, the Agency's cosponsorship Standard Operating Procedure (SOP 90 75 2, dated August 7, 1995), does not authorize SBA to disburse funds through a cosponsorship.

SBA's own internal documents contemplate that a contract, grant, or cooperative agreement would be used when disbursing Federal funds in conjunction with a cosponsorship. On June 8, 1988, SBA's General Counsel issued a memorandum entitled "Procedures for Reviewing and Approving Proposed Cosponsorship Activities." The memorandum (not a formal General Counsel opinion) contains an enclosure entitled "Legal Issues Outline for Cosponsorship Activities," and "identifies areas that should be considered in assessing the appropriateness of proposed cosponsored activities, and the manner in which they are proposed to be conducted." Disbursing funds directly to a cosponsor for services is not one of the enumerated methods in the memorandum for providing financial support to a cosponsored activity. Instead, the memorandum asks, "What mechanism is being used to disburse the funds, e.g., contract, grant or cooperative agreement?" While we do not believe this administrative checklist establishes or limits legal authority, it demonstrates that the cosponsorship statute was not interpreted as containing a separate, new grant of authority to SBA to disburse funds.

OMB Circular A-110 applies to all agreements between Federal agencies and non-profit organizations, such as MBELDEF. Paragraph 5 states in part, that: "Federal agencies responsible for awarding and administering grants to and other agreements with organizations . . . shall adopt the language in the Circular unless different provisions are required by Federal statute or are approved by OMB."

The Small Business Act does not contain different provisions and we are unaware of OMB approval to exempt SBA from these requirements. SBA did not adopt the language in the Circular for the MBELDEF cosponsorship agreement.

SBA ultimately paid its cosponsor MBELDEF \$646,610 of the budgeted \$900,000 in Federal funds under the authority of this cosponsorship agreement.

RECOMMENDATIONS

We recommend that the:

- 1A. Deputy General Counsel issue an opinion regarding the legality of SBA disbursing funds under a cosponsorship to a cosponsor absent of using authorized contract, grant or cooperative agreement procedures; and
- 1B. Associate Administrator for Business Initiatives insert a clause in cosponsorship agreements where SBA is disbursing funds to the cosponsor prohibiting disbursement unless and until he receives a signed legal opinion stating that SBA has the authority to disburse funds to the cosponsor.

SBA Management's Comments

Management officials agreed with the two recommendations contained in this finding. They disagreed that OMB Circular A-110 is applicable to this kind of agreement, but stated they "may elect" to incorporate appropriate OMB Circular provisions into future cosponsorships. They stated that SBA had used cosponsorships for many years to commit resources either through cash outlays for postage expenses or dedication of agency staff and non-cash resources. Finally, they commented that the checklist contained in SBA's General Counsel memorandum merely listed examples of funding mechanisms.

OIG Evaluation of Management's Comments

Management gave no reason why they believe that OMB Circular A-110 is not applicable to this cosponsorship, and as such we have no reason to change our conclusion on this matter. SBA signed a cosponsorship **agreement** with MBELDEF, a **non-profit organization**, and as such, OMB Circular A-110 "Uniform Administrative Requirements for Grants and **Agreements** with Institutions of Higher Education, Hospitals and Other **Non-Profit Organizations**" applies. (bold added). We do not dispute that SBA had disbursed funds to cosponsors in the past. These past actions, however, do not justify disbursing funds through a cosponsorship agreement without determining whether it had the required authority, especially since the statutory language giving SBA the authority to enter into cosponsorships does not include specific language permitting SBA to disburse Federal funds through a cosponsorship. Lastly, the 1988 Checklist is not necessarily

binding, but in our view, it is evidence that SBA management did not historically interpret the cosponsorship statute as constituting separate spending authority.

Finding 2: SBA Did Not Adequately Safeguard the Government's Interests In This Cosponsorship

SBA entered into a cosponsorship agreement to disburse up to \$900,000 to MBELDEF, without ensuring that the government's interests were safeguarded. While the Federal Managers' Financial Integrity Act of 1982 (FMFIA) and OMB Circular A-123, "Management Accountability and Control" both require SBA to take appropriate measures to ensure that funds are safeguarded against waste, fraud, mismanagement or misappropriation, the cosponsorship agreement did not include these safeguards and the cosponsorship SOP did not require them either. MBELDEF ultimately did not complete its responsibilities under the cosponsorship, and the cosponsorship has ambiguities concerning SBA's legal recourse.

SBA agreed to pay MBELDEF up to \$900,000 in appropriated funds without evaluating whether MBELDEF could do the tasks it agreed to, or making provisions in the agreement to ensure that expenditures were reasonable and performance by MBELDEF was adequate. When entering into the cosponsorship, SBA did not first determine that:

- MBELDEF was capable of completing its responsibilities under the cosponsorship;
- MBELDEF had the financial resources within the organization to complete the cosponsorship; and
- The government was paying a fair and reasonable price for what it was obtaining.

The cosponsorship did not include:

- A requirement that SBA would pay MBELDEF only for allocable, allowable and reasonable expenses;
- Penalties against MBELDEF should it not complete its responsibilities; and
- Internal controls to account for the fees MBELDEF collected under the cosponsorship, which were to be used before SBA funds.

Additionally, the SBA program official responsible for the cosponsorship was not trained to ensure that the expenditures and performance were reasonable.

By excluding these safeguards, SBA did not adhere to FMFIA, OMB Circular A-123, "Management Accountability and Control," or OMB Circular A-110. FMFIA and OMB Circular A-123 require executive agencies to take the appropriate measure to ensure that funds are safeguarded against waste, fraud, mismanagement or misappropriation. OMB Circular A-110 contains procedures to assure reasonable costs and proper accountability.

SBA entered into a cosponsorship because the ADA for GC/MED specifically wanted MBELDEF to do the work. SBA determined that MBELDEF could not qualify for a contract or grant but could qualify for a cosponsorship. The cosponsorship SOP did

not require the safeguards necessary to protect spending government funds. While most of these safeguards would have been incorporated into a contract or a 7(j) technical assistance grant to MBELDEF, SBA officials stated MBELDEF could not have received either of these for this project. According to an SBA official, SBA could not award this to MBELDEF through a contract because MBELDEF did not have expertise in logistical planning. SBA officials stated that SBA could not award MBELDEF a 7(j) grant because of reprogramming limitations that could not be overcome.

The following are examples of problems with the MBELDEF cosponsorship:

- SBA had to complete MBELDEF's cosponsorship responsibilities because MBELDEF did not complete them. According to MBELDEF's President, SBA completed the last 3 presentations because MBELDEF did not have the funds needed to pay the vendors and speakers for the events. Had SBA checked MBELDEF's financial condition and past performance before awarding the cosponsorship, it would have been apparent that MBELDEF had financial limitations and poor performance. [FOIA Ex. 4 and Trade Secrets Act] Furthermore, MBELDEF's 1997 track record was poor. MBELDEF only completed 3 of the 5 studies it contracted to do as a subcontractor for a Federal Government award. Further, an SBA official stated that MBELDEF did not have expertise in logistical planning to receive this project as a contract.
- MBELDEF did not appear to use some of the Government's money in a prudent and reasonable manner, but the cosponsorship did not contain provisions for spending funds in a reasonable and prudent manner. Because the cosponsorship did not require the expenses to be reasonable, MBELDEF had no restrictions on the use of funds, and little incentive to be prudent or reasonable in incurring expenses. Potentially unreasonable charges¹ included:
 - \$74,114 in printing charges to one company for an average of \$9,624 per site. For one of the sites, another printing company only charged \$5,000 for a similar project, about one-half the average of the other company. The first company may have been charging higher prices for "rush" jobs. This would have occurred if MBELDEF did not provide the company the materials with enough lead-time. MBELDEF's accountant stated that MBELDEF used the first printing company because they did not require immediate payment.
 - \$46,344 to pay for a project manager. The cosponsorship required MBELDEF to provide, at its own expense, a project officer and project director. The duties of all 3 individuals were not clear and may have overlapped. SBA paid for the project manager and MBELDEF failed to provide all the staff time promised for the project officer and project director.

¹ Lack of clear documentation on the purpose and basis for invoices made a full assessment difficult. Because SBA does not have a clear basis to obtain refunds, we did not assess the reasonableness of every expense paid. Had we done so, we believe other expenses would have been unreasonable.

- \$2,004 in long distance phone charges made from hotel rooms. Over a five-day period, an MBELDEF contractor charged \$322 or an average of over \$64 a day in long distance charges. Another contractor charged \$305 over a four-day period or an average of \$76 a day. Over a six-day period, a contractor charged \$417 in long distance charges, an average of more than \$69 a day. According to one of the hotels where these calls were made from, it charged a \$4.51 connection fee for each call and approximately \$4 a minute for long distance calls. Another hotel stated that it marked up long distance calls by 25 to 30 percent. A calling card could be used for a \$.80 per call connection fee and \$.28 a minute for long distance calls. The President of MBELDEF stated that its employees had calling cards and agreed that it would have been reasonable to issue calling cards to their contractors as well.
- \$2,149 in computer rental fees. One of MBELDEF's consultants charged a \$40 daily rental fee for use of his laptop computer (the total charge for these one day rentals was \$1,640). An additional computer rental of \$509 was incurred at the Orlando workshop. SBA had laptop computers, one of which should have been made available for MBELDEF's use. Even if SBA could not provide use of a computer, SBA could have purchased one for less than the rental fees and still had the computer after completion of the cosponsorship. An SBA office purchased laptop computers in September 1999 at a base price of \$1,300 and \$1,750 with items such as the LAN card, a modem, port replicator, and carrying case. According to this office, laptops purchased in 1998 would have been essentially the same price.
- \$240 in Internet connection fees. A \$20 daily Internet connection fee was charged for each day of training. On average, 2 two-day workshops were held each month, for an estimated monthly Internet connection fee of \$80. An MBELDEF contractor informed the auditors that the Internet connection fee was charged to cover his monthly Internet connection fee. According to this contractor, his monthly Internet fee was \$20 for unlimited usage.
- \$383 in duplicate meal payments. MBELDEF consultants charged full per diem of \$40 a day for breakfast, lunch and dinner during the days when breakfast and lunch were served at the workshops.
- \$342 for upgraded hotel rooms. One individual stayed in a hotel room costing \$267.90 per day while other individuals at the same site paid \$153.90 per day.
- \$333 in travel expenses. An MBELDEF contractor made a site visit to Orlando on New Years Eve, arriving on December 31 and leaving January 1. According to an MBELDEF contractor, this trip was taken to determine if construction at the hotel would be completed in time for the February Orlando workshop. MBELDEF did not make prior site visits to any of the other hotels used for the presentations.

- MBELDEF's President acknowledged that it did not provide the amount of in-kind contribution it agreed to provide. Because the cosponsorship did not contain any penalties should MBELDEF not carry out the terms of the cosponsorship, SBA has questionable recourse against MBELDEF.
- SBA could not determine the dollar value of the registration fees MBELDEF collected, even though MBELDEF was required to use these fees prior to receiving funds from SBA. An SBA official stated that SBA did not monitor or keep any records of the fees collected by MBELDEF, but relied on the information MBELDEF reported. This information may not be accurate. For example, an internal SBA e-mail correspondence stated that SBA collected \$4,230 in registration fees at the Cleveland conference and forwarded the amount to MBELDEF. However, MBELDEF reported that only \$760 in cash and checks were collected from the Cleveland conference. Also, there should have been credit card payments, but MBELDEF did not detail how much it collected in fees from credit cards from each site. Rather, it reported one lump sum total for credit card registration fees received from all the sites. SBA paid MBELDEF based on MBELDEF collecting only \$760 in Cleveland.

RECOMMENDATIONS

- 2A. We recommend that the Associate Administrator for Business Initiatives incorporate safeguards, such as all provisions of applicable OMB Circulars, into cosponsorships where SBA disburses funds to a cosponsor. If OMB Circulars do not apply, we recommend that the following provisions be included in these cosponsorships:
- a determination that the cosponsor is capable of completing its portion of the agreement;
 - a determination that the cosponsor has the financial resources within the organization to complete the agreement;
 - a determination that the government is paying a fair and reasonable price for what is being provided;
 - the cosponsorship agreement includes appropriate accountability requirements and related cost principles, particularly, a requirement that SBA will only pay expenses that are allocable, allowable and reasonable;
 - the cosponsorship agreement includes terms to deal with non-compliance by the cosponsor; and
 - the cosponsorship includes a provision for internal controls to ensure that fees collected can be properly accounted for.
- 2B. We recommend that the Associate Administrator for Business Initiatives (AA/BI) incorporate the requirement that the program official responsible for managing the cosponsorship obtain appropriate training.

SBA Management's Comments

Management officials generally agreed with recommendation 2A; but they believed that the level of "due diligence" should depend upon the circumstances. They agreed with recommendation 2B. They stated that: the safeguards placed in this cosponsorship were reasonable based on what they knew; they believed that MBELDEF could perform its responsibilities; they have not concluded that they lack recourse should MBELDEF be found in breach; and they reviewed invoices for reasonableness and disallowed some costs. Furthermore, they stated that there was no problem with a senior manager recommending a specific entity for a cosponsorship and it was circumstances other than MBELDEF's own qualifications, which discouraged issuing a grant or contract.

OIG Evaluation of Management's Comments

Regardless of what SBA knew or thought about MBELDEF, prior to disbursing up to \$900,000 of Federal funds, SBA should have implemented adequate safeguards, such as those normally found in a contract, grant, or cooperative agreement, to ensure these funds were safeguarded against waste and mismanagement. While SBA management has asserted that reasonable safeguards were included in the cosponsorship, they did not elaborate on what they were and how they protected SBA's interests. The numerous problems associated with this cosponsorship demonstrate that whatever safeguards existed were inadequate.

Finding 3: SBA Lacked Controls Over Assuring Proper Expenditure of Appropriated Funds

During some of the conferences, as part of the agenda, luncheons and other food were served to all attendees. In total, SBA and MBELDEF paid at least \$213,815 for food and refreshments. The relevant statute, 31 U.S.C. Section 1345, states:

Except as specifically provided by law, an appropriation may not be used for travel, transportation, and subsistence expenses for a meeting. This section does not prohibit – (1) an agency from paying the expenses of an officer or employee of the United States Government carrying out an official duty; . . .

The Comptroller General has applied this prohibition in cases where Government agencies have used appropriated funds for non-government personnel to attend seminars and conferences. SBA did not have controls to ensure that appropriated funds were precluded from paying for food of non-government attendees. The cosponsorship agreement provided for the collection of fees and the amount reported as collected was \$81,545. To ensure that appropriated funds were not spent improperly, SBA and MBELDEF needed to ensure that fees collected exceeded the related food costs for non-government participants. This did not occur.

Further, when vendors were not getting paid by MBELDEF and invoices were forwarded to the Office of Procurement and Grants Management (OPGM), OPGM officials requested a legal opinion on whether appropriated funds could be used to pay for food served to attendees of the SDB 12-City Program. OGC prepared a draft opinion dated April 27, 1999, which was not issued in final that concluded:

In the absence of statutory authority, or case law indicating otherwise, we conclude that SBA may not pay for the meals of the non-governmental attendees of the SDB 12-City Program.

The Director, OPGM, advised us that the above opinion was never discussed with, or provided to, OPGM. Therefore, OPGM, with a previous understanding that SBA could not pay for food, refused to pay for food expenses. GC&MED paid for the food by either paying the cosponsor who, in turn, paid the vendors, or by paying the vendors directly through a government purchase card.

RECOMMENDATION

- 3A. We recommend that the Associate Deputy Administrator of Government Contracting & Minority Enterprise Development determine the pro rata share of food costs for non-government attendees versus amount collected. If the amount collected does not cover the cost of food served to non-governmental employees, determine the remedies that SBA must take.

SBA Management's Comments

Management officials stated that they needed more time to assess this finding and make comments. They agreed with the recommendation.

OIG Evaluation of Management's Comments

This appears to be responsive.

Finding 4: SBA Did Not Take Appropriate Action When Significant Problems Arose With the Cosponsorship Agreement

SBA did not follow its own policies and procedures for dealing with performance problems on cosponsorships. As a result, SBA did not take appropriate action when it became clear that there were significant problems with completing the cosponsorship.

Though it was apparent that there were problems with MBELDEF's performance on the cosponsorship, GC/MED did not elevate the problems to the AA/BI for consideration. The cosponsorship SOP requires the responsible program official to advise the AA/BI of any issues or concerns regarding a specific cosponsorship. Upon being so notified, the AA/BI may request the Oversight Committee to consider the issues or concerns. Problems documented during the cosponsorship were:

- MBELDEF did not have adequate resources to provide the amount of personal services required as the in-kind contribution in the cosponsorship agreement without a severe impact on MBELDEF, according to MBELDEF's President. MBELDEF's President informed SBA of this situation five days after the signing of the cosponsorship agreement in a September 30, 1998, memorandum to the Acting Associate Administrator for Small Disadvantaged Business Certification & Eligibility (Acting AA/SDB) and the AA/BI. Though the President of MBELDEF requested a modification to the cosponsorship, SBA did not modify it. According to MBELDEF and SBA officials, the ADA for GC/MED told MBELDEF that they would work this out later, though no action was ever formally taken.
- Before the completion of the program introduction and outreach tour, the Deputy Associate Deputy Administrator for Government Contracting & Minority Enterprise Development (DADA for GC/MED) concluded that it appeared that MBELDEF did not have the capabilities to fulfill its responsibilities and recommended canceling the cosponsorship agreement. A March 12, 1999, memorandum from the DADA for GC/MED to the ADA for GC/MED, with a copy to the Acting AA/SDB, detailed the problems with MBELDEF's handling of the cosponsorship that caused him to come to those conclusions. These problems included average attendance for primary audience being 158 rather than the 400 that had been estimated, MBELDEF not developing a national database, MBELDEF not paying vendors, and MBELDEF not executing and providing oversight for a contract with a vendor for workshop logistics and related on-site services. At the time of this memo, the last 6 program introduction and outreach tour conferences still had not yet been conducted.
- A March 26, 1999 memorandum from the President of MBELDEF to the Acting AA/SDB detailed significant problems MBELDEF was having completing its cosponsorship responsibilities. With 4 conferences left to complete, MBELDEF complained that they had no funds to go forward, stating that various vendors would not do the work without advance payment. MBELDEF complained that SBA was withholding an advance and not processing past invoices.

In practice, BI and the Oversight Committee have never used the cosponsorship SOP provisions for elevating performance problems with cosponsorships. According to the former AA/BI, the mechanism included in the cosponsorship SOP for the Oversight Committee to consider the problems with the cosponsorship is an unused procedure. If the Oversight Committee had reviewed this situation, they could have ensured that SBA took more appropriate action. The Oversight Committee could have overruled the ADA for GC/MED's decision to keep working with MBELDEF despite the significant problems, since the ADA for GC/MED reported to the Deputy Administrator, and the Deputy Administrator was an Oversight Committee member.

RECOMMENDATION

- 4A. We recommend that the Associate Administrator for Business Initiatives take the necessary steps to ensure compliance with the requirement in SOP 90 75 2 that the responsible program officials report cosponsorship performance problems to the Associate Administrator for Business Initiatives.

SBA Management's Comments

Management officials disagreed with the finding although they generally agreed with the recommendation. Although the cosponsorship oversight committee was not notified when problems arose, management officials responded that other senior SBA staff was involved. They stated that they would clarify where the responsibility to oversee cosponsorship performance problems should rest. Management officials also disagreed that the only appropriate action was to terminate the cosponsorship relationship.

OIG Evaluation of Management's Comments

Regarding their disagreement with the finding, the informal method that was used by SBA management was not effective. In this instance, if the SOP had been followed, the problems could have been resolved early in the process.

Also, we did not state that the only appropriate action was to terminate the cosponsorship relationship. We stated that neither the problems were elevated nor the cosponsorship was canceled. To avoid confusion, we clarified the sentence and deleted that portion of the statement from the final report.

Finding 5: SBA Did Not Ensure MBELDEF Provided All Invoices

While the terms of the cosponsorship required MBELDEF to provide SBA with invoices to justify expenditures, SBA paid MBELDEF for some claimed expenses for which MBELDEF did not provide invoices. Of the approved expenses totaling \$728,156 (\$646,610 paid by SBA and \$81,546 paid by MBELDEF from attendee fees), SBA did not receive invoices for \$132,949, or 18 percent of the total. SBA officials informally exempted MBELDEF from submitting all invoices that were individually under \$1,000. These invoices under \$1,000 totaled over \$31,000. We were advised that the rationale used to exclude invoices under \$1,000 was that there were too many individual items under \$1,000 to review. An SBA official also approved payment and SBA paid MBELDEF for individual expenses exceeding \$1,000 without obtaining invoices. One such expense was for over \$77,000 (over 10 percent of the total expenses MBELDEF claimed). As a result, SBA had no assurance that costs claimed were incurred or that they related to the cosponsorship. A separate audit report is being issued that recommends recovery of unjustified payments.

RECOMMENDATION

- 5A. We recommend that the Associate Deputy Administrator for Government Contracting & Minority Enterprise Development (GC/MED) take steps to ensure that GC/MED employees enforce the terms of cosponsorship agreements for which they are the responsible program official.

SBA Management's Comments

Management officials stated that the decision to exempt invoices below \$1,000 was a well-intentioned consensus decision made for practical purposes. They believed that any larger missing invoices were due to inadvertence, but they will look into the fact that some of these larger invoices were not received. They understood that some of the paid expenses were for MBELDEF salaries, so a typical third party invoice would not be available. In the future, they stated that they will use employees that are more experienced in reviewing and tracking expenditures to better control and account for funds, and they will not exempt small value invoices without a written procedure cleared by the OIG.

OIG Evaluation of Management's Comments

Management's comments are responsive. The largest missing invoice, which was for over \$77,000 was not due to inadvertence. An SBA official noted that it was missing and recommended payment with the stipulation that MBELDEF would submit the invoice later. To date, MBELDEF has not submitted that invoice, though based on MBELDEF's accountant's oral description of what the funds were for, we do not believe that it is a justified expense. If the expenses were for MBELDEF salaries in excess of the

in-kind contribution, internal MBELDEF documentation would be considered adequate for payment.

OFFICE OF INSPECTOR GENERAL
AUDITING DIVISION

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Agency Comments to Audit
Received After Final Audit Report Issued



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

DATE: October 2, 2000

TO: Phyllis K. Fong
Inspector General

FROM: Kerry L. Kirkland *Kerry L. Kirkland*
Associate Deputy Administrator for Government
Contracting and Minority Enterprise Development

David R. Kohler *David R. Kohler*
Deputy General Counsel

Monika Edwards Harrison *John M. Belis, AAA/BI for*
Deputy to the Associate Deputy Administrator
for Entrepreneurial Development

SUBJECT: Draft Audit Report, Audit of MBELDEF Cosponsorship

We are responding to the draft audit report referenced above.

This draft report was provided to SBA officials a few days ago. You asked for the Agency's response by September 27, 2000. This period of time was not adequate to respond in detail to the findings made in this draft. We gave you a quick response on that date and we have had some further discussion.

The Agency is normally given at least 30 days by your office to comment on a draft audit report before its issuance in final form, and OMB audit procedures specify at least this period of time when GAO performs an audit and provides a draft. (OMB Circular A-50, par. 8b.) The attached comments reflect our latest views but they are not as complete as they otherwise could be, and therefore we request that your draft document, and any final version you may issue before receiving further comment from us, be treated confidentially. There are a number of important issues touched upon in this document in ways which could reflect adversely upon the Agency, and the Agency believes it may be able to provide additional information.

Attachment:

Comments on Draft Audit Report, MBELDEF Cosponsorship

Comments on Draft Audit of MBELDEF Cosponsorship

Summary: We do not agree with the highlighted items forming the basis for your conclusion that SBA did not take appropriate actions regarding this cosponsorship.

While it is true that a legal opinion examining SBA's authority was not obtained, it is true that OGC concurred in the execution of the cosponsorship agreement, and SBA's practice for many years has been to commit resources, both cash and non-cash, based upon such a document.

Second, we think safeguards were put in place which were appropriate considering the nature of the cosponsorship and the identity and reputation of our cosponsor.

Third, we think we had reasonable controls in place, and when problems emerged later, that additional controls were imposed.

Fourth, the problems that emerged were raised to the level of senior officials within the Agency, who dealt with the problems responsibly, if not immediately, even though the cosponsorship oversight committee was not convened for the purpose.

Fifth, claimed expenses may yet be justified as part of a final accounting from MBELDEF, and the Agency has not concluded that it lacks enforcement powers to the extent claimed expenses are not justified.

Finding 1. We do not agree that OMB Circular A-110 is applicable to this kind of agreement. Nonetheless, should SBA again enter into a cosponsorship involving federal funds, we may elect to incorporate by reference appropriate provisions of that circular or others. While no legal opinion has addressed squarely the authority to commit resources through the vehicle of a cosponsorship agreement, the agency has done so for many years, either through cash outlays for postage expenses or dedication of agency staff and non-cash resources. We will address this question squarely, however. The 1988 checklist mentioned in the finding does not constitute an opinion that such authority was found not to exist – in fact the funding mechanisms listed were shown as examples only.

Recommendation 1A. We agree.

Recommendation 1B. We agree.

Finding 2. The safeguards placed in this cosponsorship were reasonable based upon what we then knew. Moreover, we have not concluded that we lack recourse should MBELDEF be found in breach. We reasonably believed

MBELDEF could perform its responsibilities, and had no reason to doubt its capabilities, or that we would not pay a fair and reasonable price. In fact, we received invoices, reviewed them for reasonableness, and disallowed some costs. A description of penalties for breach is not necessary to enforce common law remedies, and depending upon a final accounting and further review, we may seek enforcement.

There is no problem with a senior manager recommending a particular entity for a cosponsorship, and it was circumstances other than MBELDEF's own qualifications which discouraged issuing a grant or contract to accomplish our desired purposes.

Recommendation 2A. We agree generally, although the level of "due diligence" we will require should depend upon the circumstances. We will issue clarifying procedures, however, on which your office will be able to comment. We will also clarify where responsibility for this due diligence should be placed, and it possibly will not be with the Associate Administrator for Business Initiatives.

Recommendation 2B. We agree.

Finding 3. We need additional time to assess this finding and make our comments.

Recommendation 3A. We agree, except that other management officials may be involved in these determinations.

Finding 4. We do not agree with this finding. SBA did take appropriate action when problems arose. It is true that a referral to the cosponsorship oversight committee was not made, and it is true that that Committee could have overruled the decision to keep working with MBELDEF to try to resolve the difficulties. However, other senior staff did get involved, and a great amount of effort was given to resolve the problems with MBELDEF while preserving SBA's credibility with the various hotels and vendors involved and the small business and government contracting communities. We do not agree that the only appropriate action was to simply terminate the cosponsorship relationship, although that was certainly considered. In practice, a decision to terminate the relationship could have been requested and possibly obtained by others involved, notwithstanding the failure to invoke the oversight committee specifically.

Recommendation 4A. We agree generally, although we will clarify where responsibility should rest to ensure compliance with the SOP procedures.

Finding 5. This finding relates to three categories of unjustified expenses claimed by MBELDEF. With respect to the bulk of these expenses, \$77,584 for "contract administration", our understanding is this sum represents salary expenses for employees hired by MBELDEF to perform its obligations under

the cosponsorship. As indicated above, there would not normally be a third-party invoice, although the expense of course should be documented. We will pursue obtaining documentation to support our understanding. On this expense and on the remaining expenses not adequately justified by MBELDEF, we intend to seek reimbursement.

Recommendation 5A. We agree, with the conditions that we first endeavor to obtain a final accounting from MBELDEF, and that the demand may be made by a different senior official.

G

AUDIT OF BOSCAERT CONSTRUCTION, INC.

AUDIT REPORT NUMBER 0-31

SEPTEMBER 30, 2000

This report may contain proprietary information subject to the provisions of 18 USC 1905 and must not be released to the public or another agency without permission of the Office of Inspector General.



U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL
WASHINGTON, D.C. 20416

AUDIT REPORT

Issue Date: September 30, 2000

Number: 0-31

To: Kerry L. Kirkland, Associate Deputy Administrator for Government
Contracting and Minority Enterprise Development

Thomas A. Dumaresq, Assistant Administrator for Administration

David R. Kohler, Deputy General Counsel

From: Robert G. Seabrooks, Assistant Inspector General for Auditing

Subject: Audit of Boscart Construction, Inc. (Boscart)

We completed an audit of SBA's (1) evaluation of Boscart's initial eligibility for the 8(a) program, (2) process for ensuring the company's continuing compliance with 8(a) program requirements, and (3) award and administration of contracts with Boscart. The 8(a) program was created to assist small business concerns owned and controlled by socially and economically disadvantaged individuals develop their business skills and become viable business firms. To be certified by SBA for participation in the program, applicants must show that their firms are owned by socially and economically disadvantaged individuals, meet SBA's small business size standards, and have a reasonable potential for success, as defined in SBA regulations. Firms in the program are eligible for contracts that Federal agencies set aside for 8(a) firms and may receive SBA technical assistance and management training. In fiscal year 1999, about 6,000 small businesses participated in the program, and \$6 billion was awarded in 8(a) contracts.

SBA's Office of Procurement and Grants Management is responsible for administering and acquiring contractual services for SBA in accordance with applicable Federal requirements. The Office of Government Contracting and Minority Enterprise Development (GC&MED) is responsible for determining the eligibility of firms for the 8(a) program.

In September 1997, SBA certified Boscart Construction Inc., a general contracting company, solely owned by its president, for participation in the 8(a) program. In October 1997, SBA appointed Boscart's owner to its National Small Business Development Center (SBDC) Advisory Board. In May 1998, SBA hired Boscart's owner's spouse as a GS-15 Schedule C (political appointee) in the Office of Capital Access. Between February and September 1998, SBA awarded six contracts to Boscart that ultimately totaled \$658,310 in value, as shown in the table below.

<u>Contract No.</u>	<u>Date</u>	<u>Amount</u>	<u>Description</u>
SBAHQ-98-M-0324	2/3/98	\$ 3,910	5 th floor build out
SBAHQ-98-V-0021	2/19/98	1,980	4 th floor conf. room doors
SBAHQ-98-M-0468	3/25/98	2,378	Fabricate door
SBAHQ-98-V-0068	6/19/98	122,900	Design Wash. Design Ctr.
SBAHQ-98-C-0012	8/17/98	36,434	Demolition, etc
SBAHQ-98-C-0014	9/1/98	<u>490,708</u>	8 th floor renovations
Total		\$ 658,310	

The last three contracts were funded by the Small Disadvantaged Business (SDB) program.

OBJECTIVES AND SCOPE

The objectives of our audit were to determine whether SBA (1) properly evaluated Boscarts initial eligibility for the 8(a) program and ensured its continuing compliance with 8(a) program requirements, and (2) awarded and administered its contracts with Boscarts in accordance with its internal procedures and applicable regulations. We reviewed SBA's files related to Boscarts, its owner and the owner's spouse, and interviewed various SBA and contractor personnel. We also analyzed accounting information and amounts paid to Boscarts for services rendered and contract performance. We conducted fieldwork during the period February to August 2000. The audit was conducted in accordance with Government Auditing Standards.

RESULTS OF AUDIT

SBA's process for evaluating Boscarts initial 8(a) program eligibility was flawed because it relied on inaccurate and unverified financial information. Subsequently, the agency did not ensure the company's compliance with 8(a) program requirements by accepting a contract on the company's behalf for which it was not eligible. In addition, SBA did not comply with (1) its standards of conduct regulations by awarding contracts without required approvals and (2) Federal Acquisition Regulations (FAR) by not documenting significant contract actions. As a result, the Agency has reduced assurance that its programs and operations are achieving their intended purposes, in accordance with prescribed policies, procedures and ethical requirements.

SBA managers provided comments to a draft of this report during several meetings. They also stated that they had insufficient time to provide a full response. A summary of their comments along with the OIG evaluation is presented after each finding.

Finding 1: Eligibility for Admission to the 8(a) Program

SBA's process for determining Boscart's initial 8(a) program eligibility was flawed because it relied on inaccurate and unverified financial information. On the Personal Financial Statements submitted with the company's 8(a) application, the company's owner and her spouse did not disclose significant amounts of unpaid Federal taxes. Nor did they disclose another significant debt, a defaulted loan, which resulted in a judgment against them for \$133,000 plus interest in 1992.

Had SBA known of these liabilities, it could have impacted on the determination that Boscart was eligible for program entry. Companies must possess reasonable prospects for success in order to be eligible for the program. One of the factors SBA evaluates in assessing potential for success is financial capacity. The undisclosed liabilities, although personal, could have had a material impact on Boscart's financial capacity because a small business concern can be significantly impacted by the owner's financial capability. SBA may have declined Boscart had it known of the undisclosed liabilities.

SBA relies partly on unverified information provided by applicants in making initial eligibility determinations, e.g. personal liabilities. Had SBA obtained a personal credit report on Boscart's owner, SBA would, in all probability, have known that the owner significantly understated her personal liabilities. The assessment of potential for success would have been based on a more accurate picture of the firm's financial capacity, which was significantly worse than what SBA thought was the case when it made its determination.

Under current regulations, if a credit report had been obtained, SBA could have found Boscart ineligible for program entry for three reasons: (1) providing false information to SBA, (2) lacking business integrity as demonstrated by the civil judgment, and (3) failure to pay significant financial obligations to the Federal government.

Recommendation

- 1A. We recommend that the Associate Deputy Administrator for GC&MED, suspend Boscart from the 8(a) program based on the owner's non-disclosure of significant personal liabilities.

SBA Management's Response

SBA management stated that it is not clear that knowledge of significant debt owed by Boscart's owner would have led to a different eligibility determination. SBA management further stated that business prospects for success are not the same as an owner's borrowing potential and the personal debt of Boscart's owner does not necessarily show a lack of business integrity. SBA management did, however, agree to consider whether suspension might be appropriate along with termination.

OIG Evaluation of Management's Response

We agree that it is not clear that knowledge of the undisclosed personal debts would have led to a different 8(a) program eligibility determination in 1997. Under current regulations, however, the non-disclosure of those debts would preclude the company's acceptance into the program. SBA management's proposed action of considering whether to suspend Boscart from the 8(a) program is responsive to our recommendation.

Finding 2: Compliance with 8(a) Program Requirements

Although Boscart did not submit 1997 financial statements in accordance with SBA requirements, and was, therefore, ineligible for 8(a) contract awards, SBA accepted on the company's behalf a sole source 8(a) contract ultimately valued at \$490,708.

Under Title 13 CFR § 124.602 (b),

[8(a)] Participants with gross annual receipts between \$1,000,000 and \$5,000,000 must submit to SBA reviewed annual financial statements prepared by a licensed independent public accountant within 90 days after the close of the concern's fiscal year.

Title 13 CFR §124.503 (c) provides further that

Once SBA determines that a procurement is suitable to be accepted as an 8(a) sole source contract, SBA will normally accept it on behalf of the Participant . . . provided that . . . the Participant has submitted required financial statements to SBA.¹

On June 25, 1998, SBA's Washington District Office (WDO) sent a letter notifying the company that it needed to provide reviewed financial statements for 1997. The letter also stated:

Firms whose financial statements are overdue and/or incomplete cannot be awarded 8(a) contracts and may be subject to termination from the 8(a) program.

In September 1998, although Boscart still had not submitted the required statements, the WDO accepted on Boscart's behalf a sole source 8(a) contract ultimately valued at \$490,708. As of May 2000, Boscart still had not submitted required financial statements, and SBA was taking steps to terminate the company from the 8(a) program.

Recommendation

- 2A. We recommend that the Associate Deputy Administrator for GC&MED, in conjunction with the Associate Administrator for Field Operations, reinforce the need for staff involved in the acceptance of 8(a) awards to ensure that program participants are in compliance with program requirements before accepting awards on their behalf.

¹ 8(a) program contracts involve three party agreements through which SBA accepts the contract on behalf of the 8(a) participant, enters into a contract with the procuring government agency and subcontracts to the 8(a) participant. In this case, SBA was also the procuring government agency, so the contract was between SBA's Office of Procurement and its Washington District Office.

SBA Management's Response

SBA management stated that these regulatory requirements are procedural in nature, for SBA's benefit, and can be waived when appropriate. Also, sole source contracting opportunities can be extended to firms that are delinquent in submitting financial statements. SBA management further stated that Boscart was not given unusual or special treatment. SBA management agreed with the recommendation to the extent of reviewing and clarifying the provisions relative to the appropriate handling of non-compliance with these provisions.

OIG Evaluation of Management's Response

The Agency responded that the "regulatory requirements are procedural in nature, for SBA's benefit, and can be waived when appropriate." We believe that (a) the Agency's acceptance of a contract for which the company was ineligible and (b) its response to the audit undermine the integrity of the 8(a) program and weaken the agency's control environment. We also believe the regulations are clear regarding (a) the requirement for 8(a) companies to submit annual financial statements and (b) the acceptance of sole-source contracts on a company's behalf – provided the company has submitted the required financial statements. The agency's June 1999 letter was also clear that the company was ineligible for 8(a) contract awards until it submitted the required statements.

We do not agree with the implication that the procedural nature of the regulations reduces the need for compliance with them. Nor do we agree with the implication that because the regulations are for SBA's benefit, the need for compliance is reduced. Firstly, the regulations are not only for SBA's benefit. They are also for the benefit of 8(a) program participants, other procuring agencies, Congress, and the taxpayer. Secondly, even if the regulations were only for SBA's benefit, without a justified and documented decision waiving the requirements by someone with appropriate authority, they should be complied with. In this case, there is no indication that SBA intended to waive the requirement. Instead, the agency subsequently began termination proceedings against the company for not submitting required statements.

We are also concerned with management's statement that "Boscart was not given unusual or special treatment." This appears to say that non-compliance with 8(a) program regulations is a common and usual occurrence.

Lastly, if SBA had complied with and enforced its regulations, the outcome for the company may have been more favorable. As it turned out, the award of the construction contract appears not to have benefited the company. Cost overruns, claims against the surety, etc. indicate that the contract may have actually damaged the company's prospects for success. If SBA had required Boscart to submit the required statements before accepting the contract, the agency may have determined that the company was not financially prepared for such a large contract and that it needed other forms of business development assistance.

Finding 3: Standards of Conduct and Advisory Board Procedures

SBA did not comply with its Standards of Conduct regulations, by awarding Boscart contracts without obtaining required Standards of Conduct Committee approvals. All of the Boscart contracts were awarded while the company's owner was a member of the National SBDC Advisory Board² and therefore, required the approval of the Standards of Conduct Committee. In addition, the Agency did not comply with its Advisory Board procedures, because it did not obtain Standards of Conduct Committee approval for Boscart's owner's appointment to the SBDC Advisory Board.

Title 13 CFR § 105.302, (Assistance to employees or members of quasi-government organizations) provides:

The Standards of Conduct Committee must approve SBA assistance³, other than Disaster loans . . . to a person if its sole proprietor, general partner, officer, director or stockholder with a 10 percent or more interest (or a household member) is a member or employee of a Small Business Advisory Council⁴ or is a SCORE volunteer.

In October 1997, the SBA Administrator appointed Boscart's owner to a three year term on the National SBDC Advisory Board, and subsequently the Agency awarded the company six sole source contracts. The Agency did not, however, obtain Standards of Conduct Committee approval for any of these awards.

In addition, when Boscart's owner was appointed to the SBDC Advisory Board, SBA did not comply with its Standard Operating Procedure 90 54 4 (SBA Advisory Councils) which states:

No person can be appointed to an Advisory Council if he or she already is an applicant for or recipient of SBA assistance (other than disaster loans . . .) without prior written approval of the Standards of Conduct Committee, which will determine if there is any significant conflict of interest or the appearance of a conflict of interest

Boscart was accepted into the 8(a) program in September 1997, prior to the owner's appointment to the SBDC Advisory Board. Under 13 CFR § 105.201, the owner was, therefore, a recipient of SBA assistance. SBA's Standards of Conduct Committee did not, however, approve her appointment to the Advisory Board.

² This board was established by law to advise and confer with SBA on SBDC policy matters.

³ SBA assistance is defined in 13 CFR § 105.201 as "financial, contractual, grant, managerial or other aid, including size determination, section 8(a) participation, licensing, certification, and other eligibility determinations made by SBA."

⁴ Under the Federal Advisory Committee Act, "an advisory committee means any committee, board, commission, council . . . established . . . in the interest of obtaining advice. . . ."

Recommendation

3A. We recommend that the Designated Agency Ethics Official review the Agency's policies and procedures for ensuring compliance with the Agency's Standards of Conduct Regulations and revise those policies and procedures as necessary. The Agency should as part of this process develop means for sharing and accessing essential information between Agency offices, e.g., a more effective "vetting" process.

SBA Management's Response

SBA management agreed with the finding and recommendation.

Finding 4: Ethics Opinion Regarding Boscart Contracts

An ethics opinion regarding SBA contracts with Boscart was inconsistent with the facts and with the Office of Government Ethics' government-wide treatment of spouses for purposes of conflict of interest analyses. After SBA's Assistant Administrator for Administration became aware that Boscart's owner's spouse was a SBA employee, he requested advice from the Designated Agency Ethics Official (DAEO), asking whether Boscart's "continued performance of the contract violated any ethics laws, regulations or policies."

The DAEO responded in a memorandum dated September 2, 1998: "*Based on the facts presented, it is our opinion that neither the award or the performance of the Boscart contract violates ethics laws, regulations, or policies.*" The DAEO provided the following rationale for this conclusion:

The contract was awarded prior to [his] SBA employment, he is not an owner, officer, or director of Boscart, and he has no official Agency duties that relate to Boscart or the 8(a) program.

This statement "*the contract was awarded prior to [his] SBA employment*" was inaccurate for two reasons. First, SBA awarded Boscart three contracts, not just one, related to the "design and construction of new office space for the SDB and HubZone programs" – the subject of the DAEO's memorandum. Second, Boscart's owner's spouse began employment at SBA on May 25, 1998, and the first of the three subject contracts was awarded on June 19, 1998, three weeks later.

Accordingly, the facts suggest that contractual assistance to Boscart may have needed the prior approval of the Standards of Conduct Committee in accordance with 13 CFR §105.204 (Assistance to SBA employees or members of their household) which states:

Without the prior written approval of the Standards of Conduct Committee, no SBA assistance, other than Disaster loans . . . shall be furnished to a person when the sole proprietor, partner, officer, director or significant stockholder of the person is an SBA employee or a household member.

The DAEO's memorandum also stated:

- *[Boscart's owner's spouse] states that he and his wife are legally separated and planning a divorce. They no longer share a household.*
- *. . . future assistance to Boscart, if [he and his wife] reconcile their differences and she becomes a member of his household, will require standards of conduct approval.*

In the latter statement, the DAEO indicated that contracts with Boscart did not require standards of conduct approval, because the company's owner and her spouse were separated and did not share a household. Title 13 CFR § 105.201 provides:

Household member means spouse and minor children of an employee, all blood relations of the employee and any spouse who resides in the same place of abode with the employee.

The DAEO's opinion indicated that Boscart's owner was not a "household member" for standards of conduct purposes, because she and her spouse were separated. According to an attorney at the Office of Government Ethics (OGE), however, for purposes of both 18 USC § 208 (actual conflicts of interest) and 5 CFR § 2635.502 (appearance of conflicts) (both government-wide authorities), OGE views a legal separation as having no impact on the definition of "spouse," when determining whether there is an actual conflict or an appearance of a conflict of interest. In other words, even when two married individuals have a legal separation agreement and are living apart, they are treated as a married couple by OGE for purposes of performing conflict of interest analyses.

Recommendation

- 4A. We recommend that the Deputy General Counsel revise 13 CFR §105.201 to clarify that an employee's spouse should be considered a "household member," whether or not the spouse resides in the same place of abode with the employee, so long as they are legally married.

SBA Management's Response

SBA management stated that SBA's regulations deal only with receipt of Agency assistance, not with conflict of interest cases covered by OGE regulations. SBA management agreed to review its regulations on this point, but stated that it may elect to treat a separated spouse differently from the OGE regulations.

OIG Evaluation of Management's Response

Management's comments are responsive to the recommendation.

Finding 5: Contract Administration

SBA did not properly administer two of its contracts with Boscart. It is not clear from the files that contract requirements were completed in accordance with the statements of work. Certain aspects of the administration of Boscart's contracts did not comply with various provisions of the Federal Acquisition Regulations (FAR). Also SBA increased one of the contracts by \$70,000, more than eight months after the contract completion date, without any rationale in the file to justify the amount of the increase.

Contract No. SBAHQ-98-V-0068

On June 19, 1998, SBA awarded Boscart a fixed-price contract in the amount of \$17,250 for design of 15,000 square feet of office space on the 8th floor of the Washington Design Center. The work was to be completed by July 31, 1998. On August 11, 1998, SBA modified this contract to extend the completion date to October 30, 1998, and increase the scope of work. Under the modified contract, the price was increased to \$52,900, and Boscart was to design an additional 31,000 square feet of office space on the 2nd, 5th and 8th floors of the Washington Office Center. It is not clear from the contract files whether Boscart completed all of the work specified.

Contract No. SBAHQ-98-C-0014

On September 1, 1998, SBA awarded Boscart a \$406,029 contract for construction of new office space on the 8th floor of the Washington Design Center. The contract required the company to complete the project by September 30, 1998. On September 28, 1998, the SBA program office (GC & MED) approved a requisition to add \$70,000 to the contract for "unforeseen construction increases." On September 30, 1998, the SBA Contracting Officer sent Boscart a letter (see Attachment 1) that appears to be a change order under the changes clause of the contract (FAR clause 52.243-4). The letter authorized Boscart "to proceed" and "to incur costs in an amount not to exceed \$70,000." The letter also stated that "the contract will be increased by that amount."

Paragraph (d) of FAR Part 52.234-4 Changes clause provides, in part

If any change under this clause causes an increase or decrease in the Contractor's cost of, or the time required for the performance of any part of the work under this contract, whether or not changed by any such order, the Contracting Officer shall make an equitable adjustment and modify the contract in writing.

Despite the Contracting Officer's letter stating the contract price will be increased and the requirement of FAR 52.242-4(d), the construction contract was not modified for the \$70,000 increase.

The contract also required Boscart to obtain payment and performance bonds within 10 days of the contract award. Under FAR § 52.228, Boscart should have provided the bonds

before work began. Boscart did not, however, provide the bonds until October 6, 1998, over a month after work had started and the company had been paid about \$144,000. In order to obtain the bonds, Boscart signed an agreement providing for SBA to make subsequent contract payments through a lockbox for the benefit of the bonding company.

The project encountered a series of delays and difficulties, including cost overruns, a mechanics lien and claims of more \$178,000 by subcontractors against the surety company that bonded the contract. On March 3, 1999, SBA sent Boscart a letter (see Attachment 2) stating: "effective immediately, you are hereby directed to cease all further work toward completion of the punchlist items."⁵ The letter cited the company's failure to complete 80 percent of the punchlist, and stated "another contractor will complete the punchlist items, and the cost will be deducted from your contract." Subsequently, in June 1999, the company submitted a request to SBA for an additional \$322,000 – based on cost overruns, modifications, etc.

Although the March 1999 letter directing the company to cease work on the punchlist and the Agency's subsequent interactions with the company had many of elements of a contract termination, the agency did not follow the procedures described in FAR Part 49 - Termination of Contracts. Instead, according to agency officials, all open issues were settled in a negotiation using procedures authorized by FAR 33.214 - Alternative Dispute Resolution (ADR).⁶

Specifically, in July 1999, according to SBA officials, "SBA settled all open issues in controversy by:

- (1) *Increasing the amount of the design contract⁷ and paying Boscart an additional \$70,000, and*
- (2) *Not requiring Boscart or the surety company to complete the items on the punchlist. (SBA subsequently paid other contractors over \$15,000 to complete some of these items.)*
- (3) *Determining that all contracts were completed in a satisfactory manner."*

Under FAR Part 33.214, "the objective of using ADR is to increase the opportunity for relatively inexpensive and expeditious resolution of issues in controversy." Under FAR Part 33.201, "Issue in controversy" means a material disagreement between the Government and the contractor which

- (1) *May result in a claim or*
- (2) *Is all or part of an existing claim.*

⁵ A punchlist is a list of discrepancies that need to be corrected by the contractor. In this case, the three page punchlist described such items as HVAC system, millwork, doors, and finish work that needed to be completed.

⁶ Under FAR Part 33.201, "Alternative Dispute Resolution" (ADR) means any type of procedure or combination of procedures voluntarily used to resolve issues in controversy.

⁷ All design contract funds had been either expended or deobligated in September 1998.

There was, however, no evidence in the contract files to support the need for ADR. Although SBA officials informed us they did not agree with Boscart's \$322,000 request, there was no evidence of a review or analysis of the request to specify the basis for a "material disagreement." There was also no documentation to support that the agency's actions involved a settlement. The \$70,000 increase to the design contract, which more than doubled the contract price, was supported by the September 1998 requisition to modify the construction contract – for "unforeseen construction increases." The payment of the \$70,000 was supported by a request for payment from Boscart for unspecified work performed on the design contract. The construction contract file had no documentation relating to (a) Boscart's request for a \$322,000 increase, (b) the resolution of the punchlist items, or (c) the justification for "determining that the contracts were completed in a satisfactory manner." In fact, the last evidence of communication with Boscart in the construction contract file was the letter directing the company to cease work on the punchlist items.

The lack of documentation describing and supporting these actions and circumstances did not comply with FAR Part 4.801(b) requirements that:

The documentation in the files (see 4.803) shall be sufficient to constitute a complete history of the transaction for the purpose of –

- (1) Providing a complete background as a basis for informed decisions at each step in the acquisition process;*
- (2) Supporting actions taken;*
- (3) Providing information for reviews and investigations; and*
- (4) Furnishing essential facts in the event of litigation or congressional inquiries.*

Without documentation describing and supporting the circumstance and actions related to the administration of these contracts, we were not able to fully evaluate their propriety.

Recommendation

- 5A. We recommend the Assistant Administrator for Administration take appropriate actions and complete the documentation of the contract files, for the two Boscart contracts discussed above, to comply with the requirements of the FAR.

SBA Management's Response

SBA management did not believe its contract administration was flawed. SBA management further stated that Boscart did an exceptional job in meeting SBA's design requirements, and in fact performed work that exceeded the value of the contract. SBA also obtained an amicable solution to cost overrun problems, and agreed to increase the value of the design contract by \$70,000. SBA management did, however, agree to complete documentation of the contract file.

OIG Evaluation of Management's Response

We do not agree with management's assertion that the contract administration was not flawed. We believe the absence of documentation supporting actions taken and the resolution of various issues is a significant deficiency. Without adequate documentation, the propriety of various actions and resolution of issues can not be determined. At best, this leaves open the possible appearance of impropriety.

* * * *

The findings and recommendations in this audit report are based on the conclusions of the Auditing Division. The recommendations are subject to review, management decision and corrective action by your office in accordance with existing Agency procedures for audit follow-up and resolution.

Please provide us your management decision for each recommendation within 30 days. Your management decisions should be recorded on the attached SBA Forms 1824, Recommendation Action Sheet, and show either your proposed corrective action and target date for completion, or explanation of your disagreement with our recommendations.

Should you or your staff have any questions, please contact Robert Hultberg, Director, Business Development Programs Group at (202) 205-7204

Attachments.



U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

September 30, 1998

Barbara Turner
Boscart Construction, Inc.
1080 Wisconsin Ave. NW, Suite 300
Washington, DC 20007

Subject: Contract SBAHQ-98-C-0014; Eighth Floor Renovations

Dear Ms. Turner,

The Small Business Administration's Office of Procurement and Grants Management has reviewed and approved your proposal for the estimated additional amount of \$70,000.00 under the subject contract. The contract will be increased in that amount. Therefore, you are hereby authorized to incur costs in an amount not to exceed \$70,000.00.

All services rendered should be in accordance with your proposal. Any variation should be discussed with the Contracting Officer immediately prior to making any changes. Your Contracting Officer Technical Representative for this effort is Ms. Michelle Hodges. She can be contacted at (202) 205-7018.

This notification is authorization to proceed. However, please note that acceptance of your proposal is subject to final negotiations, which should take place within the next 30 days. Please refer to the requisition number 8.6368.0356 in all correspondence relative to this action.

If you have any questions, please call me at (202) 205-7051.

Sincerely,

A handwritten signature in cursive script, appearing to read "Deborah M. Woods".

Deborah M. Woods
Contracting Officer

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416



March 3, 1999

Barbara Turner
Boscart Construction, Inc.
1080 Wisconsin Ave., NW, Suite 300
Washington, DC 20007

Subject: Contract SBAHQ-98-C-0014, 8th Floor Renovations

Dear Ms. Turner:

This letter is in reference to the punchlist items for the subject contract.

In our letter of December 16, 1998, the prompt and timely completion of the punchlist was stressed. In addition, in our meeting of December 17, 1998, you stated that completion of the punchlist items would begin on January 4, 1999. To date, approximately 80 percent of the punchlist items have not been completed.

Therefore, effective immediately, you are hereby directed to cease all further work towards completion of the punchlist items. Another contractor will complete the punchlist items, and the cost will be deducted from your contract.

If you have any questions regarding this matter, please contact me at (202) 205-7051.

Sincerely,

Deborah M. Woods
Contracting Officer

cc: Michelle Hodges, COTR

Agency Comments to Audit
Received After Final Audit Report Issued





U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

DATE: October 2, 2000

TO: Phyllis K. Fong
Inspector General

FROM: Kerry L. Kirkland *Kerry L. Kirkland*
Associate Deputy Administrator for Government
Contracting and Minority Enterprise Development

Thomas A. Dumaresq *Thomas A. Dumaresq*
Assistant Administrator for Administration

David R. Kohler *David R. Kohler*
Designated Agency Ethics Official

SUBJECT: Draft Audit Report, Boscart Construction, Inc.

We are responding to the draft audit report referenced above.

This draft report was provided to SBA officials a few days ago. You asked for the Agency's response by September 27, 2000. This period of time was not adequate to respond in detail to the findings made in this draft. We gave you a quick response on that date and we have had some further discussion.

The Agency is normally given at least 30 days by your office to comment on a draft audit report before its issuance in final form, and OMB audit procedures specify at least this period of time when GAO performs an audit and provides a draft. (OMB Circular A-50, par. 8b.) The attached comments reflect our latest views but they are not as complete as they otherwise could be, and therefore we request that your draft document, and any final version you may issue before receiving further comment from us, be treated confidentially. There are a number of important issues touched upon in this document in ways which could reflect adversely upon the Agency, and the Agency believes it may be able to provide additional information.

Attachment:

Comments on Draft Audit Report, Boscart Construction, Inc.

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Finding 1. It is not clear that knowledge of significant debt owed by Boscart's owner would have led to a different eligibility determination. Business prospects for success are not the same as an individual's credit history. And business financial capacity is not the same as an owner's borrowing potential. This personal debt does not necessarily show a lack of business integrity.

We of course are troubled by false information submitted to us. We understand that program termination proceedings have commenced against Boscart.

Recommendation 1A. We will consider whether suspension may be appropriate along with termination.

Finding 2: These regulatory requirements are procedural in nature, for SBA's benefit, and can be waived when appropriate. Sole source contracting opportunities can be extended to firms delinquent in submitting financial statements. Boscart was not given unusual or special treatment.

Recommendation 2A. We agree with this recommendation to the extent of reviewing and clarifying the provisions relative to the appropriate handling of non-compliance with these provisions.

Finding 3. We agree.

Recommendation 3A. We agree.

Finding 4. We agree that the DAEO's advice was based upon a misunderstanding of contracting facts. The SBA's regulations deal only with receipt of agency assistance, not with conflict of interest cases covered by OGE regulations. It should remain within the discretion of the ethics officials when to insist on those conditions.

Recommendation 4A. We agree to review our regulations on this point, but we may elect to treat a separated spouse differently from the OGE regulations

Finding 5. We believe our contract administration was not flawed. Boscart did an exceptional job in meeting our design requirements, in fact performing work that exceeded the value of the contract. We obtained an amicable solution to cost overrun problems, and agreed to increase the value of the design contract by \$70,000.

Recommendation 5A. We agree to complete documentation of the contract files.