



U.S. OFFICE OF SPECIAL COUNSEL

1730 M Street, N.W., Suite 300  
Washington, D.C. 20036-4505

The Special Counsel

January 17, 2001

The President  
The White House  
Washington, D.C. 20500

Re: OSC File No. DI-00-0147

Dear Mr. President:

In accordance with 5 U.S.C. § 1213(e)(3), I am transmitting a report from the Honorable Phyllis K. Fong, Inspector General, Small Business Administration (SBA), sent to me pursuant to 5 U.S.C. §§ 1213(c) and (d). The report sets forth the findings and conclusions of the SBA's review of disclosures of information allegedly evidencing violations of law, rule, or regulation, a gross waste of funds, and an abuse of authority by officials of the Small Business Administration, Washington, D.C. I transmitted the disclosure to the Honorable Aida Alvarez, Administrator. Ms. Alvarez delegated authority to Ms. Fong to respond pursuant to 5 U.S.C. § 1213(c).

The whistleblower, Mr. Jose Gutierrez, declined to provide comments on the agency report to this office pursuant to 5 U.S.C. § 1213(e)(1).

We have carefully re-examined Mr. Gutierrez's original disclosures and reviewed the agency's response. As described below, I have determined that SBA's findings substantiating the essence of Mr. Gutierrez's disclosure – that a high-level SBA official used money allocated to a certification program for small, disadvantaged businesses, to pay costs and expenses associated with other SBA programs – appear reasonable within the meaning of section 1213(e)(2). Indeed, the Inspector General's investigation went beyond Mr. Gutierrez's specific allegations to examine the SBA's overall administration of the grant programs and contracts implicated in the allegations.

**1. The Whistleblower's Disclosures**

Mr. Gutierrez, who consented to the release of his name, alleged that his supervisor, Dr. Richard Hayes, Deputy Associate Administrator for Government Contracting and Minority Enterprise Development (GC/MED), misappropriated funds in the millions of dollars, used appropriated funds for purposes other than those for which the funds were appropriated, and 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 personal friend.

Mr. Gutierrez was appointed in October 1998 as Associate Administrator for Minority Small Business/Capital Ownership Development (MSB/COD), in the Senior Executive Service. He was given management responsibility over three programs administered under the Small Business Act, 15 U.S.C. § 631, *et seq.*, as amended: (1) the Section 8(a) contract assistance program; (2) the Section 7(j) grants program; and (3) the newly created Small Disadvantaged Business (SDB) program.

The SDB program was created to handle the certification and processing of private businesses to enable them to participate in the federal contract bid process. For this service, the SDB collected a fee from participating federal agencies. OMB transferred this funding to the SDB through an allocation from the funding authorized to other federal agencies. In the last quarter of FY98, when the program began, approximately \$12 million was transferred. In FY99, the SDB program collected \$11 million. According to Mr. Gutierrez, this money was intended to cover the SDB program operating expenses. Mr. Gutierrez alleged that, instead, Dr. Hayes authorized the use of some of this money for other agency programs and expenses.

## **2. Summary of Report**

The SBA response comes from the SBA Office of Inspector General (OIG). It contains seven documents addressing Mr. Gutierrez's allegations: (1) List of Allegations, Findings and Agency Comments and Actions; (2) Administrator's Response to OIG findings; (3) SBA OIG Report of Investigation; (4) SBA OIG Draft Audit of Small Disadvantaged Business (SDB) Certification Program Obligations and Expenditures; (5) SBA OIG Audit of Minority Business Enterprise Legal Defense and Education Fund, Inc. (MBELDEF), Cosponsorship Expenses and Income; (6) SBA OIG Audit of SBA's Administration of the MBELDEF Cosponsorship; and (7) SBA OIG Audit of Boscart Construction, Inc.

The gravamen of Mr. Gutierrez's disclosures is that a high-level SBA official used money allocated to a certification program for small, disadvantaged businesses, to pay costs and expenses associated with other SBA programs. The report fully substantiated this allegation, and found, through an audit, that funds appropriated for the SDB program, approximately \$3 million, were used for non-SDB purposes. The report substantiated a number of Mr. Gutierrez's related allegations that this official, Dr. Hayes, engaged in contracting improprieties and violated standards of conduct and other federal regulations in the administration of SBA programs. The report also found that Dr. Hayes abused his authority by ignoring evidence of compounding problems in the administration of a cosponsorship agreement between SBA and a contractor. The specific findings of the report are discussed below.

### **a. Violation of Law Governing Use of Appropriated Funds**

Mr. Gutierrez's allegations that funds appropriated for the Small Disadvantaged Business (SDB) program were used for non-SDB purposes were substantiated. The SBA OIG conducted an audit for the stated purpose of determining whether the SBA used SDB funds for their intended purpose. The OIG reviewed a sample of \$13.6 million of total expenditures and

obligations made as of July 31, 1999. It found that \$3 million of the sampled expenditures and obligations were used for non-SDB purposes, in violation of the Economy Act and appropriations law. The unallocable expenses were for construction and furnishings, equipment, personnel costs, consulting costs, training, and marketing. The audit could not determine what portion of an additional \$3.2 million in expenditures should have been paid with SDB funds because of insufficient supporting documentation.

In addition, the audit found improper and unsupported distribution of overhead and electronic application system costs to the SDB certification program. The Office of the Chief Financial Officer charged \$2.8 million in overhead to SDB funds for FY98 and FY99, based on arbitrary and unsupported percentages. SDB funds also paid for an electronic application system to be used for more than the SDB program.

The audit also found that the SDB program was overstaffed and purchased excess equipment and furniture, some of which remained in storage for more than one year. The audit cited questionable legal opinions from the OGC, justifying the use of SDB funds to pay for employees who performed less than 100% of SDB work. The audit identified violations of regulations requiring inventory of equipment.

Two other allegations relating to the use of SDB funds for non-SDB purposes were substantiated. Mr. Gutierrez alleged that Dr. Hayes used SDB funds for the award of contracts to Research Planning, Inc. (RPI), to establish a business assessment tool for the benefit of the Section 8(a) program, and to upgrade the executive information system for the SBA Minority Enterprise Development program. Mr. Gutierrez also alleged that Dr. Hayes authorized two training conferences that covered non-SDB related training. Mr. Gutierrez's allegation that two contracts were awarded to the African American Small Business Exporters Association using SDB funds, was not substantiated.

The audit made numerous specific recommendations for the adjustment and reallocation of expenditures and obligations, and the reimbursement of funds to other federal agencies if a reallocation determines that there were overcharges. The audit also recommended the de-obligation of unexpended balances remaining for ineligible obligations.

The 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 de-obligate \$.6 million from SDB obligations. The agency states that in each case of misallocation described in the audit report, SBA used funds available for support of the 8(a) program since 8(a) firms are also SDB firms.<sup>1</sup> After the audit fieldwork was completed,

---

<sup>1</sup> While the OIG found that the agency's comments were, for the most part, responsive to the recommendations made by the OIG (and the agency agreed to implement the recommendations), the OIG was critical of the agency's justification for the misallocation. The OIG Evaluation of Management's Response (Appendix D to the Audit of Small Disadvantaged Business Certification Program Obligations and Expenditures, Audit Report No. 00-19) observed that while 8(a) firms are necessarily SDBs, that does not mean that SDB funds should

the SBA completed a cost allocation study, which justified the \$2.8 million that had been allocated to overhead.

Although the agency has adopted the recommendations of the OIG for corrective action, it has not acknowledged, and affirmatively denies, wrongdoing or bad faith on the part of SBA officials. It should be noted that the agency has asserted that all decisions were made in good faith, and that all funding allocations were, in the agency's view, justified, legal, and appropriate. By way of explanation, the agency stated that the number of certification applications it actually received fell well below expectations, and projections for staff, facilities, and equipment requirements were largely overstated.

The agency has agreed to make the reimbursements as recommended, and has also appointed new managers to administer its government contracting and minority enterprise development programs generally, has reorganized that office for tighter accountability, and has instituted approved accounting controls.

b. Violation of Conflict of Interest Laws in the Selection of a Contractor

Mr. Gutierrez's allegations of violations of conflict of interest laws were substantiated. While the report found that there was no evidence of collusion to enhance the value of the contract for the build out of the 8<sup>th</sup> floor, or that Boscart falsified cost data, the report disclosed violations of law, rule, or regulation in connection with several contracts awarded to Boscart, including the contract for the 8<sup>th</sup> floor build out. The agency failed to comply with certain provisions of the Section 8(a) program and agency standards of conduct regulations, by accepting a contract on the company's behalf for which it was not eligible. The agency also violated Federal Acquisition Regulations by not documenting significant contract actions.

The report did not substantiate the allegation that Dr. Hayes was involved in the selection of a contractor, Boscart Construction. It also concluded that Dr. Hayes and Oscar Turner, who was married to the owner of Boscart Construction, were not personal friends. Dr. Hayes, therefore, could not have improperly influenced the selection of the contractor to benefit a friend. The report concluded that the selection of the contractor did not violate competitive bidding laws because the contract was under \$3 million, and competitive bidding procedures were not required. The report substantiated Mr. Gutierrez's allegation of violation of 13 CFR § 105.302, finding that the agency 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. With respect to the allegation that violations of 13 CFR § 105.202 and 203, and 5 CFR § 2635.101 occurred, the report noted that the agency's selection of Boscart for the 8<sup>th</sup> floor build out contract may have suggested an appearance of preferential treatment because Boscart's owner was the wife of an SBA employee, but did not substantiate the allegation.

---

pay for costs that have been historically paid for with 8(a) funds and that are for the use of the 8(a) program. The 8(a) program receives funding through the SBA budget, and SDB certification funds should not be used to augment the 8(a) budget.

Finally, the report found that although the allegation that Boscart defaulted on the eighth floor build out contract was not substantiated, the evidence revealed that the agency directed Boscart to cease work on punch-list items, incurred additional costs of at least \$15,000 to complete the punchlist items, and settled a request for payment of \$322,000 by Boscart for cost overruns and contract modifications by making a \$70,000 increase to one of the contracts without adequate documentation to justify that action.

The agency response to the audit and the OIG findings indicates that although the agency does not agree that Boscart was ineligible to receive the contract, or that violations of law occurred, "except in a procedural sense," it plans to review the relationship between noncompliance with technical aspects of 8(a) program participation and contract award opportunities, and then issue clarifying procedures. The agency takes the position that the regulatory requirements are "procedural in nature," for SBA's benefit, and can be waived when appropriate. It asserts that Boscart was not given special or unusual treatment.<sup>2</sup> The agency proposes to improve its documentation and information sharing, in response to findings in the audit that its contract administration was flawed because of inadequate documentation supporting actions taken and the resolution of issues. The agency believes that the SBA received full value for the money spent on the Boscart contracts.

c. Violation of Conflict of Interest and SBA Regulations in Solicitation of Employment and Billing Irregularities regarding MBELDEF Co-sponsorship Agreement

The report did not substantiate Mr. Gutierrez's direct allegation that Dr. Hayes directed Anthony Robinson, President of MBELDEF, to hire Mr. Turner. The information developed in the investigation was conflicting and inconsistent, according to the report. The report did conclude that Dr. Hayes violated 5 CFR § 2635.101(8), when he *recommended* that MDELDEF hire Mr. Turner to work on the co-sponsorship agreement.<sup>3</sup>

---

<sup>2</sup> The OIG was critical of the agency's position that the regulations were procedural in nature and could be waived. The OIG noted that the regulations are for the benefit of 8(a) program participants, other procuring agencies, Congress, and the taxpayer. According to the OIG, the inference to be drawn from the agency's response is that the procedural nature of the regulations reduces the need for compliance with them, and that non-compliance with 8(a) program regulations is a common and usual occurrence. The OIG is of the opinion that had SBA complied with and enforced its regulations, the outcome for the contractor may have been more favorable.

<sup>3</sup> It should be noted that the evidence strongly favors a finding that Dr. Hayes' influence was closer to coercion than "recommendation." While the report concluded that there was no coercion in the hiring of Oscar Turner by MBELDEF (Dr. Hayes did not demand that MBELDEF hire Turner), the evidence did disclose that Mr. Robinson felt that he should not simply "dismiss" a recommendation coming from someone like Dr. Hayes. Mr. Robinson also wrote a letter to SBA officials in 1999, asserting that the SBA "insisted" that he hire Mr. Turner.

The allegation that Dr. Hayes abused his authority by improperly influencing the selection of MBELDEF was not substantiated. Based on the evidence revealed in investigating this allegation, the OIG concluded that Dr. Hayes did abuse his authority when he ignored continuing and compounding problems with the cosponsorship agreement and prohibited his staff from taking any corrective action.

The report did not substantiate the allegations of violations of 13 CFR §§ 105.202 and 203 regarding restrictions on the award of contracts to concerns employing former SBA employees. Mr. Turner was an SBA employee at the time the co-sponsorship agreement was signed, but he had no discretion over the agreement or its administration. In addition, the report stated that a co-sponsorship is not officially considered assistance, and therefore the restrictions of 13 CFR § 105.203 do not apply.

The report partially substantiated Mr. Gutierrez's allegation that Charles Payne, then Chief of Staff, Minority Enterprise Development, prepared a memorandum that facilitated payment of MBELDEF invoices and that the memorandum could not be supported. An audit of the MBELDEF co-sponsorship agreement 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. MBELDEF was also exempt from submitting invoices under \$1,000. These invoices totaled \$31,000. The audit found that SBA did not take appropriate actions both before and after signing the cosponsorship agreement, which committed SBA to disburse up to \$900,000 in government funds to MBELDEF.

The agency's response to the report states that the agency believes it is not clear whether Dr. Hayes violated ethics regulations, and that without further inquiry, the agency is not able to conclude that an abuse of authority occurred. Even if such actions did occur, the agency can take no action against Dr. Hayes because he is no longer employed by SBA.

The agency comments on the report do not acknowledge improper conduct on the part of any SBA official, particularly with respect to the payment of smaller invoices. As to the larger invoices, the agency proposes to look into the OIG's findings, and to press MBELDEF for a final accounting. In future cases where a co-sponsorship involves an expenditure of federal funds, the agency plans to utilize the services of employees experienced in reviewing and tracking expenditures to better control and account for funds. The agency also pledged not to exempt small-value invoices absent a written procedure cleared by the OIG.

The OIG also conducted an audit review of SDB funds used by MBELDEF under the cosponsorship agreement, 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 to determine whether MBELDEF properly accounted for the fee income it collected. The co-sponsorship agreement provided that SBA and MBELDEF would cosponsor training regarding new program rules and contracting procedures. The audit found that MBELDEF was paid \$121,394 for unjustified expenses under the cosponsorship. In addition, MBELDEF did not provide the amount of in-kind

contribution agreed, and did not provide documentation supporting the accuracy of the fees it collected.

The agency agreed with OIG's recommendation that SBA require MBELDEF to reimburse SBA for nearly \$120,000 in unsupported expenses, provided that SBA first endeavor to obtain a final accounting from MBELDEF. The agency also stated its intention to reinforce the standard provisions invoking the agency's oversight committee when problems in administration arise. The agency will make it clear that concerned employees may communicate directly with the committee.

Although not specifically alleged by Mr. Gutierrez, the audit raised the question of the legality of cosponsorship agreements as a funding mechanism. The agency's comments on the audit report point out that 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. The agency has pledged to address this question directly. In addition, the comments provide context and explanation for the agency's actions in response to the problems with MBELDEF's performance under the contract, and the agency's efforts to preserve SBA's credibility with outside vendors.

d. Violation of Law in Solicitation of Grant Recipient

The report did not substantiate Mr. Gutierrez's allegations that Dr. Hayes solicited the University of North Carolina to apply for a Section 7(j) grant in an attempt to curry favor for himself, or that Americorps/Vista received a grant for which it was ineligible. The report found that Dr. Hayes did not participate in attempts to get the University of North Carolina to apply for a 7(j) grant, and that he did not seek employment with UNC. The report also concluded that Americorps/Vista was permitted to apply for 7(j) grant funds, based on an opinion issued by the SBA's Office of General Counsel.

**3. Special Counsel's Comments**

The OIG's findings substantiating the essence of Mr. Gutierrez's disclosure – that Dr. Hayes engaged in a gross mismanagement of the SDB program by violating federal regulations in the administration of certain contracts and misusing SDB funds – appear reasonable within the meaning of section 1213(e)(2). Notwithstanding the agency's reluctance to adopt fully the OIG's findings, the actions taken and planned by the agency address the deficiencies identified and are indicative of the agency's intent to take appropriate corrective action on the areas of major concern.

It is of some concern that, in the face of the report's findings and conclusions, the agency has not taken or proposed to take any measures to discipline the officials responsible for the problems and improprieties in contract administration. In part, the agency's explanation for this inaction is that the primary subject, Dr. Hayes, is no longer with the agency. With respect to the remaining findings concerning the SBA's decisions to use SDB funds for non-SDB related projects, and its handling of problems with the MBELDEF and

Boscart performance deficiencies, the agency offers that it has relied on the advice of the Office of General Counsel and the agency ethics office in its decision making. On that basis, the agency asserts that all decisions were made in good faith and were justified. Notwithstanding its position, the agency has proposed to address areas of major concern through policy changes, stricter controls, and management personnel changes. For these reasons, the failure to take disciplinary action is less troubling, and the report appears reasonable despite these concerns.

Finally, I note that there is tension between the findings stated in the OIG's report and the conclusions drawn by the Administrator. With the exception of the findings on the misallocation of SDB program funds, and the accounting of funds in connection with the MBELDEF cosponsorship, the Administrator has not adopted the findings of wrongdoing identified by the OIG. It is of some concern that, having delegated full authority to the OIG in these matters,<sup>4</sup> the Administrator now chooses to reject, or at a minimum, to question, the conclusions drawn from the evidence obtained by the OIG. Notwithstanding her disagreement with certain of the findings, the Administrator has proposed to act on all of the allegations substantiated. It should also be noted that in the four matters referred for audit by the OIG, the Administrator has generally agreed to and adopted the recommendations for corrective action where the OIG noted deficiencies.

I have determined, pursuant to section 1213(e)(2), that the agency's report contains all of the information required under section 1213(d), and that the findings of the agency head appear to be reasonable, for the reasons stated above.

As required by section 1213(e)(3), I have sent a copy of the report to the Chairmen of the House and Senate Committees on Small Business. We have also filed copies of the report in our public file and closed the matter.

Respectfully,



Elaine Kaplan

Enclosure

---

<sup>4</sup> The Administrator's delegation included the authority to investigate all aspects of the allegations made by Mr. Gutierrez, including "the authority to review and sign a report of the investigation and to transmit such report to the OSC, as well as performing any further appropriate actions in regard to these matters." The OIG viewed the delegation narrowly, producing a Report of Investigation (ROI) setting forth its findings on the evidence. The ROI makes no recommendations for action, but was submitted to the Administrator for a statement of action on those findings substantiated by the ROI. The Administrator's response on the ROI findings is included as a part of the report to OSC.