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

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Certification Program Obligations and Expenditures

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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. Pena*, 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 Ex. (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 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

INELIGIBLE OBLIGATIONS

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

DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

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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.

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
Joseph P. Loddo, Chief Financial Officer

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 wrong-doing 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. [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. Pena, 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

(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.

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

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 Joseph P. Loddo, CFO
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 8^{th} 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 8^{th} 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.

APPENDIX E

OFFICE OF INSPECTOR GENERAL
AUDITING DIVISION

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