CONCERNS RELATED TO [EXEMPTION 6] COMPLIANCE WITH 8(A) BUSINESS DEVELOPMENT PROGRAM REQUIREMENTS

MANAGEMENT ADVISORY REPORT NUMBER 6-27

SEPTEMBER 8, 2006

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

MANAGEMENT ADVISORY REPORT
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TO: David Dickson
District Director, Philadelphia District Office

/s/ Original Signed
FROM: Debra S. Ritt
Assistant Inspector General for Auditing

SUBJECT: Concerns Related to **[EXEMPTION 6]** Compliance with 8(a) Business Development Program Requirements

During February 2006, the Office of Inspector General (OIG) initiated an audit to review two sole source 8(a) set-aside **[EXEMPTION 4]** awarded by the Department of the Army, Corps of Engineers. The overall objective of the audit was to determine whether the **[EXEMPTION 4]** were awarded and performed in compliance with 8(a) Business Development program laws and regulations. Although the audit is ongoing, the OIG has identified concerns regarding **[EXEMPTION 6]** work performance on one of the subject 8(a) **[EXEMPTION 4]**, number **[EXEMPTION 2]**, that warrant your immediate attention. **[EXEPMTION 6]** is an 8(a) firm serviced by the Small Business Administration's (SBA) Philadelphia District Office.

The concerns are based on our review of applicable Federal laws and regulations; interviews with SBA officials from the Office of Size Standards, Office of Government Contracting, Office of Business Development, Philadelphia District Office, and officials from the Philadelphia District Army Corps of Engineers (Philadelphia Corps of Engineers), who were responsible for the contract's procurement and completion; and review of documentation provided by **[EXEMPTION 6]**, the Philadelphia Corps of Engineers, and SBA related to the procurement and performance of the subject contract.

CONCERNS

[EXEMPTION 6] did not complete its **[EXEMPTION 4]** contract in accordance with applicable SBA requirements. Specifically, **[EXEMPTION 6]** employees did not perform the percentage of work specified by SBA requirements and misrepresented itself as a small business under the contract's specified size standard. Furthermore, evidence exists that **[EXEMPTION**

6] was aware of the requirements and its responsibilities prior to and during contract performance.

[EXEMPTION 6] Did Not Perform the Required Percentage of Work

According to documentation provided by **[EXEMPTION 6]** during the course of the audit, it did not perform the required percentage of work in accordance with SBA small business procurement regulations. 13 CFR 124.510(a) requires an 8(a) participant to perform a specified percentage of work with its own employees on each 8(a) contract it receives. The percentage is based on the type of service provided. According to SBA government contracting officials, **[EXEMPTION 4]** are considered general construction for purposes of applying the 8(a) work performance requirements. Accordingly, **[EXEMPTION 6]** was required to perform at least 15 percent of the cost of the contract, excluding materials, with its own employees.

In determining whether **[EXEMPTION 6]** performed its required share of the work, we reviewed the accepted contract cost proposal, subcontracting agreement, and payroll records for all of the labor used on the project, including subcontractors. Our review of these documents disclosed that **[EXEMPTION 6]** did not complete the required percentage of work for the services provided. **[EXEMPTION 6]** subcontracting agreement with **[EXEMPTION 6]** indicated that the subcontractor would provide all work described in the prime contract, including the **[EXEMPTION 4]**. **[EXEMPTION 6]** also agreed to perform any work omitted from the subcontracting agreement's scope of work that was necessary to finish the contract. The OIG believes that the subcontracting agreement between **[EXEMPTION 6]** and **[EXEMPTION 6]** documents **[EXEMPTION 6]** intent to have the subcontractor perform the entire contract.

We also calculated the percentage of work performed by **[EXEMPTION 6]** employees, using the criteria in 13 CFR 125.6, which totaled 1.9 percent. We compared this to regulatory and contract performance requirements. The regulations require that at least 15 percent of the cost of general construction contracts, excluding materials, be performed by the contractor's own employees. This requirement is found in Federal Acquisition Regulations (FAR) 52.219-14, *Limitations on Subcontracting*, and it is incorporated as a performance clause in the contract in accordance with FAR 19.811-3(e). Because **[EXEMPTION 6]** did not perform the required 15 percent, it violated SBA 8(a) program requirements and the terms of its 8(a) contract. We have included our calculation of **[EXEMPTION 6]** share of the work performed as an attachment to this report.

According to Philadelphia Corps of Engineers and SBA Philadelphia District Office officials, **[EXEMPTION 6]** should have been aware of its responsibilities regarding the work percentage requirements. The Philadelphia Corps of Engineers' contracting officer stated that **[EXEMPTION 6]** required work percentage was specifically addressed during the August 30, 2005, pre-construction conference. The contracting officer told us that she attended the conference to discuss with **[EXEMPTION 6]** her concerns about the limited amount of work to be performed by **[EXEMPTION 6]** in its cost proposal and to inform **[EXEMPTION 6]** of its work performance responsibility under the terms of the contract. At the conclusion of

the conference, she believed **[EXEMPTION 6]** understood its responsibilities and would perform more work with its own employees. The contracting officer's statements and **[EXEMPTION 6]** agreement to complete more work were independently verified by the contracting officer's representative and a construction manager who attended the conference. However, despite **[EXEMPTION 6]** acknowledgement that it needed to perform more of the contract, payroll data revealed that it only incurred $400 in additional costs, equating to 10 additional hours of work. The contracting officer was surprised by this information and said **[EXEMPTION 6]** involvement was well below her expectations.

We also found an August 9, 2005, letter to **[EXEMPTION 6]** from its SBA Business Development Specialist that pre-dated the conference. The letter erroneously informed **[EXEMPTION 6]** that it was required to perform 25 percent of the work on the contract with its own employees. SBA's Office of Government Contracting and Business Development confirmed that this percentage was in error, and that the 15-percent requirement in the contract was the correct percentage. Nevertheless, we believe **[EXEMPTION 6]** knew its work performance requirements from the contract provisions it agreed to when signing the contract, discussions at the pre-conference meeting, and SBA's letter. Despite this knowledge, **[EXEMPTION 6]** did not comply with the terms of the contract and 8(a) program regulations.

[EXEMPTION 6] Did Not Meet the Applicable Size Standard

Our review further disclosed that **[EXEMPTION 6]** did not meet requirements mandated by the contract's size standard and inaccurately certified it was small when offering its proposal to the procuring agency. 13 CFR 121.405 requires a contractor to certify that it is a small business under the size standard corresponding to the contract's assigned North American Industry Classification System (NAICS) code. The NAICS code is selected by the procuring agency's contracting officer based on the principal product or service being acquired. In 2005, the size standard for the **[EXEMPTION 4]**, required that a firm have no more than $17 million in annual receipts and use its own equipment or equipment owned by another small **[EXEMPTION 4]** for at least 40 percent of the **[EXEMPTION 4]**.

In order to determine whether **[EXEMPTION 6]** complied with the 40 percent small business equipment requirement, we obtained from **[EXEMPTION 6]** a list of the equipment used for completing the **[EXEMPTION 4]** including equipment provided by a subcontractor, or a third party. The list showed that **[EXEMPTION 6]** provided all the equipment for the contract's performance.

We also compared **[EXEMPTION 6]** list of subcontractor-supplied equipment with equipment reported in the Daily Construction Quality Control Reports. As shown in the following table, the majority of the equipment used to complete the project was supplied by **[EXEMPTION 6]**. The Philadelphia Corps of Engineers confirmed that **[EXEMPTION 6]** provided all the equipment for the contract.

A Comparison of Subcontractor-Supplied Equipment Reported by [EXEMPTION 6] and in Daily Construction Reports

[EXEMPTION 6] list of subcontractor-supplied equipment	Equipment list provided in the daily construction quality control reports
EXEMPTION 4	

Discussions with officials at the SBA Philadelphia District Office and Philadelphia Corps of Engineers revealed that **[EXEMPTION 6]** may have been unclear about acceptable ways to meet the 40-percent equipment requirement. Months prior to receiving the contract, **[EXEMPTION 6]** formed a Mentor/Protégé relationship with **[EXEMPTION 6]** under SBA's Mentor/Protégé Program. According to the Assistant Administrator for Size Standards, **[EXEMPTION 6]** could have used **[EXEMPTION 6]** equipment to meet the 40 percent requirement if the mentor and protégé were awarded the contract as a joint venture. However, as stated in the Notice of Award and the contractor's certification in the contract, this contract was awarded solely to **[EXEMPTION 6]** and was not a joint venture. Consequently, **[EXEMPTION 6]** and **[EXEMPTION 6]** were independent contractors and **[EXEMPTION 6]**, as the prime contractor, could not use **[EXEMPTION 6]** equipment towards meeting the 40 percent requirement.

CONCLUSION

Based on the information provided by **[EXEMPTION 6]**, the Philadelphia Corps of Engineers, and SBA regarding contract performance, **[EXEMPTION 6]** did not meet the percentage of work and applicable size standard to be certified as small in its contract proposal. Consequently, **[EXEMPTION 6]** violated SBA's small business procurement requirements, failed to comply with the terms of its contract, and provided inaccurate information to the Federal Government in order to obtain the **[EXEMPTION 4]**.

According to 13 CFR 124.303, SBA may terminate a participant from the 8(a) program before the end of the concern's program term for "good cause." We believe that the concerns outlined in this memo provide sufficient justification for "good cause" to terminate **[EXEMPTION 6]** from the program. We also believe it provides adequate basis to suspend **[EXEMPTION 6]** during termination proceedings in order to protect the interests of the Federal government and the small business community. Pursuant to 13 CFR 124.305, SBA may suspend a concern when it shows a clear lack of program eligibility or conduct, indicating a lack of business integrity.

RECOMMENDATION

We recommend that the District Director for the Philadelphia District Office:

1. Initiate termination proceedings and immediately suspend **[EXEMPTION 6]** from the 8(a) program.

SBA MANAGEMENT'S RESPONSE AND OIG'S EVALUATION OF MANAGEMENT'S RESPONSE

The District Director for the Philadelphia District Office concurred with the OIG's concerns and the recommendation. The District Director agreed to:

- Immediately suspend **[EXEMPTION 6]** due to their fraudulent intent of not addressing the 40 percent size standard certification requirement, and

- Initiate termination proceedings against **[EXEMPTION 6]** by conducting an investigation of their past performance on other 8(a) contracts and reviewing their financial statements to determine if this was an isolated occurrence or if there is a trend in **[EXEMPTION 6]** failing to comply with small business contract work performance requirements.

The District Director further stated that if this was an isolated occurrence, **[EXEMPTION 6]** will receive a warning and their suspension will be rescinded, however, if it is determined that **[EXEMPTION 6]** failed to meet the work performance requirements for other 8(a) contracts, he will continue with termination proceedings and **[EXEMPTION 6]** will remain suspended. The District Director stated that the investigation would be complete and a final decision provided by October 15, 2006. The District Director's proposed actions are responsive to the recommendation.

* * * * *

The findings included in this report are the conclusions of the Office of Inspector General's Auditing Division. The findings and recommendation are subject to review,

management decision, and corrective action by your office in accordance with existing Agency procedures for audit follow-up and resolution.

Should you or your staff have any questions, please contact Robert G. Hultberg, Director, Business Development Programs Group at (202) 205-**[EXEMPTION 2]**.

Attachment 1

The OIG's Calculation of [EXEMPTION 6]Share of the Work Performed on the [Exemption 4] Contract

Cost Category	Cost
Cost of the contract	
Amount paid to Norfolk	$1,230,358
Fuel expense	$198,476
[EXEMPTION 6] payroll expense	$20,560
Payroll burden expense	$6,168
Estimated overhead	$128,019
Bonding expense	$29,304
Estimated insurance	$17,070
Total	**$1,629,955**
Less materials	**$198,476**
Total cost of the contract, excluding materials	**$1,431,479**
Percentage of the contract cost, excluding materials, performed by [EXEMPTION 6] ($26,728/ $1,431,479)	**1.9%**

Attachment 2

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